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No. ———

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

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CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

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On Appeal from the Supreme Court of the State of California

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JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

1. Whether the California Supreme Court erred in invalidating, in its entirety, a formal interpretive regulation of the Comptroller of the Currency providing that federal law preempts state price regulation of bank service charges on checking accounts offered by a national bank.

2. Whether the power of a national bank to "receive deposits" and related "incidental powers" under Section 24 (Seventh) of the National Bank Act authorize a national bank, notwithstanding contrary state price limits, to set the price terms on which it will receive deposits.

3. Whether the federal authority of the Comptroller of the Currency to examine and to seek modification of the service charge structure of a national bank preempts concurrent state jurisdiction to examine and to modify such service charges.

4. Whether a federal requirement that national banks set service charges for non-sufficient funds checks at levels designed to deter the writing of such checks by depositors preempts, as to national banks, a state requirement that such charges must be cost justified.

5. Whether federal bank-deregulation legislation preempts state price regulation of bank service charges on checking accounts offered by federally insured institutions.

PARTIES

The caption includes all parties. Although the complaint alleges that this case has been brought as a class action, no certification of a class has yet been made. Pursuant to Rule 28.1, appellant advises that its parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates are Midland Bank plc, Crocker National Corporation, Midland California Holdings Ltd., Pacific Overseas Finance Corporation, and Crocker Servicos Limitada.*

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* On or about December 30, 1985, Midland California Holdings Ltd. will transfer the shares it currently holds in Crocker National Corporation (the parent of Crocker National Bank) to Midland America Corporation. Pacific Overseas Finance Corporation (a subsidiary of Crocker National Bank) has been sold as of the date hereof, subject to final approval by the Federal Reserve Board.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	1
JURISDICTION	1
STATUTES AND REGULATIONS AT ISSUE	2
STATEMENT	2
THE QUESTIONS ARE SUBSTANTIAL	8
1. The Federal Power to Receive Deposits	8
2. The Exclusivity of the Comptroller's Power to Review Pricing by National Banks	14
3. The Federal Requirement to Price to Discourage NSF Checks	17
4. The Federal Deregulation Acts	18
5. The Need for Review	23

TABLE OF AUTHORITIES

Cases Page

Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981) 22
Associated Creditors Agency v. *Davis*, 13 Cal. 3d 374, 530 P.2d 1084, 118 Cal. Rptr. 772 (1975) .. 5
Belknap v. *Hale*, 463 U.S. 491 (1983) 25
Capital Cities Cable, Inc. v. *Crisp*, —— U.S. ——, 104 S. Ct. 2694 (1984) 18
City of Burbank v. *Lockheed Air Terminal*, 411 U.S. 624 (1973) 17
Columbia Broadcasting System v. *Democratic National Committee*, 412 U.S. 94 (1973) 10
Conference of Federal Savings & Loan Ass'ns v. *Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980) 17
Cox Broadcasting Corp. v. *Cohn*, 420 U.S. 469 (1975) 24, 25
Davis v. *Elmira Savings Bank*, 161 U.S. 275 (1896) 10
Fidelity Savings & Loan Ass'n v. *De La Cuesta*, 458 U.S. 141 (1982) 25
First National Bank v. *Missouri*, 263 U.S. 640 (1924) 10
Ford Motor Credit Co. v. *Milhollin*, 444 U.S. 555 (1980) 10
Franklin National Bank v. *New York*, 347 U.S. 373 (1954) 8, 9, 10, 11, 12
Hines v. *Davidowitz*, 312 U.S. 52 (1941) 17, 18, 20, 21
Jacobs v. *Citibank, N.A.*, 61 N.Y.2d 689, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (Ct. App. 1984) .. 23
Maryland v. *Louisiana*, 451 U.S. 725 (1981) 17
Merrill v. *Federal Open Market Committee*, 516 F. Supp. 1028 (D.D.C. 1981) 10
Miller v. *Youakim*, 440 U.S. 125 (1979) 10
National State Bank, Elizabeth, N.J. v. *Long*, 630 F.2d 981 (3d Cir. 1980) 15, 16, 23
New Mexico v. *Mescalero Apache Tribe*, 462 U.S. 324 (1983) 17, 21
New York Department of Social Services v. *Dublino*, 413 U.S. 405 (1973) 10

TABLE OF AUTHORITIES—Continued

Page

Pennsylvania Bankers Ass'n v. *Commonwealth, Bureau of Consumer Protection*, 58 Pa. Commw. 170, 427 A.2d 730 (1981) 15, 16, 23
Ray v. *Atlantic Richfield Co.*, 435 U.S. 151 (1978) .. 16, 22
Red Lion Broadcasting Co. v. *FCC*, 395 U.S. 367 (1969) 10
San Diego Bldg. Trades Council v. *Garmon*, 359 U.S. 236 (1959) 22
Southland Corp. v. *Keating*, 465 U.S. 1 (1984) 25
Third National Bank v. *Impac Ltd., Inc.*, 432 U.S. 312 (1977) 25
Train v. *Natural Resources Defense Council*, 421 U.S. 60 (1975) 10
White Mountain Apache Tribe v. *Bracker*, 448 U.S. 136 (1980) 16, 20

Federal Statutes and Regulations

12 U.S.C.

1 ..... 10, 14
9 ..... 10, 14
24 ..... 2, 8, 9
26 ..... 10, 14
93a 10, 14
161(a) 10, 14
191 14
201-211 14
481 ..... 10, 14, 17
482 10
484 ..... 2, 15, 16, 23
504 14
1812 14
1817 14
1818 ..... 10, 14
1821(c) 14
1832(a) 19
1972 14
3501 2
3502 ..... 2, 10
3503(a) 19, 20

TABLE OF AUTHORITIES—Continued

	Page
3503(c)	2
3504	2
3505	2
28 U.S.C.	
1257(2)	2
1257(3)	2
2103	2
12 C.F.R.	
7.6025(b)	15
7.6025(c)	14, 17
7.8000	1, 2
12 C.F.R.	
217.7 (*repealed* 1980)	18
329.6 (*repealed* 1980)	18
526.3 (*repealed* 1980)	18
48 Fed. Reg. 54319 (1983)	1, 2
49 Fed. Reg. 28237 (1984)	1, 2

Public Laws

Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469	2, 15, 18
The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132	2, 18

Congressional Materials

Competition & Conditions in the Financial System, Part I: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong., 1st Sess. (1981)	19, 20
Depository Institutions Deregulation Act of 1979, Part II: Hearings Before the Subcommittee on Fin. Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 96th Cong., 1st Sess. (1979)	19
Message from President Carter to the House of Representatives Transmitting Recommendations for Comprehensive Financial Reform Legislation, H. Doc. 96-129, 96th Cong., 1st Sess. (May 22, 1979)	19

TABLE OF AUTHORITIES—Continued

Page

S. Rep. No. 368, 96th Cong., 1st Sess. (1979) 19, 20
S. Rep. No. 536, 97th Cong., 2d Sess. (1982) 15
125 Cong. Rec. H2506 (daily ed. May 1, 1979) 19
125 Cong. Rec. S7726 (daily ed. June 14, 1979) 20
125 Cong. Rec. S7730 (daily ed. June 14, 1979) 19

State Statutes

California Civil Code
§ 1670.5 ..... 1, 2, 6
§ 3548 4
California Financial Code
§ 865.4 5

Other Authorities

BNA, *Daily Rep.*, No. 3, Jan. 6, 1984 20
Comptroller's Handbook For National Bank Examiners (1977) 2, 14, 17
San Francisco Chronicle, July 20, 1985 5
Sheshunoff, *Pricing Bank Services and Loans* (1984) 5

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JURISDICTIONAL STATEMENT

OPINIONS BELOW

The opinion of the California Supreme Court (App. A) appears at 38 Cal. 3d. 913, 216 Cal. Rptr. 345, 702 P.2d 503. The order of the Superior Court (App. B) and the decision of the Court of Appeal of the First Appellate District (App. C) are not published. The interpretive regulation of the Comptroller of the Currency appears at 12 C.F.R. 7.8000, and 48 Fed. Reg. 54319 (Dec. 2, 1983), *amended* 49 Fed. Reg. 28237 (July 11, 1984) (both App. I).

JURISDICTION

This is an appeal from a decision of the California Supreme Court reversing a judgment of dismissal by the trial court, and sustaining the application of a state statute, Cal. Civ. Code § 1670.5, as a basis for regulating

the amount of service charges of a national bank, against a claim that such application is preempted by federal law. Jurisdiction is based on 28 U.S.C. 1257(2). Judgment was entered below on July 18, 1985 (App. A). A timely petition for rehearing was denied on August 15, 1985 (App. E). The notice of appeal was timely filed on September 5, 1985, in the California Supreme Court (App. F). Should any issue herein not be appealable by right, appellant requests that this jurisdictional statement be treated as a petition for a writ of certiorari. 28 U.S.C. 2103 and 1257(3). 28 U.S.C. 2403(b) may be applicable.

STATUTES AND REGULATIONS AT ISSUE

The relevant texts of the applicable statutes and regulations are set forth in the Appendix as follows:

1. Sections 24 and 484 of the National Bank Act of 1864, 12 U.S.C. 24 (Seventh), 484 (App. G).

2. The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, 12 U.S.C. 3501-3505, and the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469, 12 U.S.C. 3503(c) (both in App. H).

3. Interpretive Regulation of the Comptroller of the Currency, 12 C.F.R. 7.8000, 48 Fed. Reg. 54319 (Dec. 2, 1983), *amended* 49 Fed. Reg. 28237 (July 11, 1984) (App. I).

4. Comptroller's Handbook For National Bank Examiners (1977) (App. J).

5. California Civil Code Section 1670.5 (App. K).

STATEMENT

1. In a number of virtually identical class actions in California, including this case, various consumer plaintiffs challenge the right of various banks to set prices

at which they offer checking account services.[1] The plaintiffs contend that the marketplace has not properly valued the checking account services of banks and seek to have the courts reduce bank service charges (fees charged by banks for various services associated with checking accounts) to levels reflecting their "true value."[2] They also seek massive refunds of past bank service charges to the extent found to be "excessive." Appellant Crocker National Bank contends that such state price control is preempted, as to national banks, by the National Bank Act and, as to federally insured institutions, by federal legislation in 1980 and 1982 deregulating deposit accounts.

In 1983, the Comptroller of the Currency, the officer charged by Congress with administering national banking laws, issued a formal interpretive regulation directly

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[1] There are 28 such cases in California. Although the present case is not yet certified as a class action, several, including *Abascal* v. *Crocker National Bank* (San Francisco Sup. Ct. No. 720-309), are certified as statewide class actions and are close to trial. Fourteen cases, including those approaching trial, have been stayed pending the outcome of this appeal. Similar cases have recently been filed against national banks in Alaska, and plaintiffs therein have moved for a stay pending the outcome of this appeal. Other similar cases have been filed in Oregon and New York.

[2] The checking accounts at issue are ordinary checking accounts. When accounts are opened, the consumer becomes entitled to benefits resulting from the bank's duty to honor checks from sums on deposit and to pay interest, if it is an interest-bearing account. The consumer typically agrees to pay the bank's standard service charges for account-related services, including a monthly maintenance fee. Among other charges, banks typically charge a "returned item" charge when the consumer writes a check without sufficient funds and the bank returns it to the presenting party, and an "overdraft charge" when the consumer writes a check without sufficient funds and it is honored. The latter two charges are known as "NSF" charges because they relate to "non-sufficient funds" or "NSF" checks. The present case and all other NSF cases in California and, we believe, elsewhere seek to challenge both types of NSF charges.

on point (App. I). This ruling provides that state price regulation of a national bank's service charges is preempted by federal law. It provides that review and modification of the amount of such charges is exclusively the Comptroller's responsibility (App. I at 79a, 84a). The Comptroller also submitted a parallel argument in an *amicus curiae* brief to the California Supreme Court in this case (App. L). That court, however, held that state courts may regulate bank service charges in statewide class proceedings, and may invalidate any charge found to be "unreasonable" or "unconscionable" in amount, after hearing evidence on the "true value," cost, and justification for the charge. The court rejected all preemption arguments.

2. This purported class action was filed in the Superior Court in San Francisco in 1978 (App. D). Plaintiff is a Crocker checking account customer. He incurred a six-dollar returned item service charge when he wrote a check without depositing sufficient funds in his account (App. D ¶ 17). The complaint alleges that Crocker's charge is unenforceable because it allegedly "costs" a bank only thirty cents to process an NSF check (App. D ¶¶ 18, 45). Plaintiff seeks to require Crocker to "cost-justify" its NSF charges for returned items and for overdrafts. To the extent these charges are then determined to be "excessive," plaintiff seeks: (i) retrospectively, a statewide refund of past charges to a statewide class of all depositors; and (ii) prospectively, a court order requiring Crocker to process class members' NSF checks at a drastically reduced price in the range of thirty cents per NSF check.

Significantly, plaintiff does not allege that Crocker's NSF charges are excessive compared with market prices of other financial institutions. In fact, the complaint concedes (App. D ¶ 25) that the charge is "similar" to

NSF charges elsewhere in the market.[3] Nor is there any allegation of price-fixing or other anti-competitive behavior. The complaint does not deny, moreover, that Crocker has fully complied with consumer disclosure laws requiring written notice of service charges when the account is opened and before any later increase.[4] Indeed, plaintiff has conceded that he knew the amount of the charge (App. C at 42a, 46a, 49a). Consequently, this action, like many others now pending, is a frontal assault on the normal right of a bank to determine the price at which it will sell its services in the competitive marketplace.

The trial court dismissed the complaint for failure to state a claim (App. B). The Court of Appeal for the First Appellate District affirmed (App. C).

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[3] At the time the complaint was filed in 1978, Crocker's charges were $5 for an overdraft and $6 for a returned item. Each is currently $10. Today, similar charges range from $6 to $15 in California, *San Francisco Chronicle*, July 20, 1985, at 2, col. 2, and from $0 to $25 elsewhere in the United States. Sheshunoff, *Pricing Bank Services and Loans* 1-2 (1984).

[4] California Financial Code § 865.4 so requires. Under California rules of pleading, it is presumed that the law has been obeyed unless there is an allegation to the contrary. Cal. Civ. Code § 3548; *Associated Creditors Agency* v. *Davis*, 13 Cal. 3d 374, 402, 530 P.2d 1084, 118 Cal. Rptr. 772 (1975). The complaint does not allege that Crocker failed to comply with the disclosure law (App. A at 3a n.3, 5a n.6; App. D). Although the court below ambiguously stated at one point that Crocker had not furnished the depositor with the "applicable bank rules and regulations" (App. A at 3a), the court acknowledged that Crocker "post[ed] notice of its rates" (App. A at 5a & n.6). On the present record, it must be presumed that Crocker has provided consumers with the written price disclosures required by § 865.4. At all events, plaintiff has conceded herein that he was aware of the amount of Crocker's NSF charges (App. C at 42a, 46a, 49a).

The disclosure requirement of § 865.4 was part of a state statutory scheme to facilitate price competition and thus to facilitate regulation of prices by the marketplace.

3. The California Supreme Court reversed. It held that a bank does not have the right to establish the price at which it will sell its services in the marketplace. Although the court held that there was a valid deposit contract requiring the customer to pay the service charge (App. A at 7a), the court held that consumers may challenge the amount of service charges as "unconscionable" and may require banks to appear in proceedings under Section 1670.5 of the California Civil Code (App. K) to review the "justification" for the amount of any service charge. If the amount is found "unconscionable," the court may invalidate it (App. A at 7a-14a). The court also held that a bank's right to increase service charges from time to time is subject to a duty to set "reasonable" charges and that judicial review is available to determine whether any increase is "reasonable" (App. A at 7a). The court so held even though a consumer, after advance written notice of an increase, can close the account if the consumer believes the charge is unreasonable (App. A at 5a & n.6).

In determining whether a service charge is excessive or unconscionable, the court held the trial court may consider, among other factors: (i) the "cost" to the bank to provide the service; (ii) "the basis and justification for the price"; and (iii) the "true value" of the service (App. A at 11a).[5]

The breadth of the court's ruling is shown by its further holding that *even a price equal to or less than a prevailing market price may be so invalidated* (App. A at 11a-13a). Crocker pointed out below that no decision in the United States had ever declared unconscionable a contractual price term that was not excessive in relation to the *market* price for similar services. Crocker fur-

[5] Other factors include: whether the market structure is oligopolistic; the price paid by similarly situated consumers; the absence of meaningful choice; the lack of sophistication of the buyer; and the presence of deceptive practices (App. A at 11a-12a, 34a n.42).

ther noted, and the court acknowledged (App. A at 13a n.14), that plaintiff conceded that Crocker's charges were comparable to similar charges in the marketplace (App. D ¶ 25). No allegation of anti-competitive behavior, as stated, has ever been made in this case.

Even so, the court held that a market price of an *entire industry* may be invalidated. This could happen, the court stated (App. A at 11a), where the structure of the industry is "oligopolistic." By this, the court presumably meant that the trial court may conduct a full-scale industry review, *i.e.*, determining the relevant market, identifying its structure, and studying the pricing behavior of individual sellers, before determining if the contract price is enforceable. In addition, the court suggested that a market price of an entire industry may be set aside when an investigation of industry pricing behavior shows it is not "free and competitive" (App. A at 36a n.43). The court stated that a market is *not* "free and competitive" when sellers set prices simply "to minimize customer dissatisfaction" (*ibid.*). This illustrates the potential breadth of the decision, for it is generally believed that taking anticipated consumer responses into account in setting prices for goods and services is an important feature of price competition.[6]

4. Appellant and the Comptroller argued below that such state control of service charges of a national bank

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[6] The court stated (App. A at 36a n.43):

> Defendant consistently assumes throughout its argument that because its charges for processing NSF charges are within the range of fees charged by its competitors, its fees are the product of a free and competitive market. The conclusion does not follow from the premise. It may well be, as plaintiff charges, that banks do not compete in the setting of NSF check fees, but set fees arbitrarily, *deterred only by the desirability of minimizing customer dissatisfaction.*

(Unless otherwise indicated, all emphasis in citations herein is supplied.)

is preempted by federal law.[7] The Comptroller emphasized this position by issuing a formal interpretive regulation (App. I). The regulation states that national banks have the right, under federal law, to set the prices at which they will provide services in the marketplace, free of state price regulation and subject to review only by the Comptroller (*ibid.*). The court below dismissed the Comptroller's interpretive regulation as "palpably erroneous" (App. A at 28a). It declined to give deference to the Comptroller's interpretation of the national banking laws, and rejected all preemption arguments (App. A at 19a-37a). Those federal preemption arguments are now presented for this Court's review.

THE QUESTIONS ARE SUBSTANTIAL

1. *The Federal Power to Receive Deposits*

The National Bank Act empowers national banking associations to "receive deposits" and empowers them to exercise "all such incidental powers as shall be necessary to carry on the business of banking . . . ." 12 U.S.C. 24 (Seventh) (App. G). These provisions preempt the type of state price regulation of service charges of a national bank authorized by the decision below.

The analogy to *Franklin National Bank* v. *New York*, 347 U.S. 373 (1954), is very close. There, this Court held that precisely the same provisions of the Act preempted a state law prohibiting the words "saving" or "savings" in a national bank's advertisements. This Court explained:

> The United States has set up a system of national banks as federal instrumentalities to perform various

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[7] The preemption issue was raised initially in the state court of appeal. That court did not reach the issue, despite briefing by Crocker and the Comptroller, because it ruled in Crocker's favor on state law issues.

> functions such as providing circulating medium and government credit, as well as financing commerce and acting as private depositories. *Some of their functions, especially as a source for federal credit, depend upon their success in attracting private deposits.*
>
> * * * *
>
> The National Bank Act authorizes national banks to receive deposits *without qualification or limitation*, and it provides that they shall possess "all such incidental powers as shall be necessary to carry on the business of banking . . . ."
>
> * * * *
>
> Modern competition for business finds advertising one of the most usual and useful of weapons. We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business.

Id. at 375-77.

The case for preemption here is even more compelling. The decision below permits a state court to prohibit a national bank from receiving any deposits at all, except on drastically reduced price terms. The Comptroller, charged by Congress with the enforcement of the national banking laws, has determined that such restrictions "impair the ability of national banks to exercise their authority to take deposits under 12 U.S.C. 24 Seventh" (App. I at 78a). This conclusion seems plainly correct, for if the "useful" power to advertise to attract deposits cannot be denied, the *essential* power to set the price terms under which a national bank shall accept deposits surely cannot be abridged.[8]

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[8] Although the court below dismissed the Comptroller's formal interpretive regulation as "palpably erroneous" (App. A at 28a), deference to the Comptroller's interpretation is required. *First*, "the construction of a statute by those charged with its execution

The court below rejected the analogy to *Franklin*. It stated that the state advertising restriction in that decision impeded a bank's "ability to *attract* deposits" whereas, in the present setting, state price restrictions will not *deter* deposits (App. A at 31a). This is a meaningless distinction. A law requiring free checking accounts would be "attractive" to depositors, but few banks could afford to offer them. The test is not merely whether the state regulation deters deposits but also whether it *impairs* the efficiency of a national bank receiving deposits. *Davis* v. *Elmira Savings Bank*, 161 U.S. 275, 283 (1896); *First National Bank* v. *Missouri*, 263 U.S. 640, 656 (1924). The price restrictions authorized below fail that test, for the following reasons.

First, the decision below authorizes state courts to deny the federal power to receive deposits, except on price terms set by state courts after years of litigation. This prohibition may apply even though the customer,

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should be followed unless there are compelling indications that it is wrong." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969); *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 565-68 (1980); *New York Department of Social Services* v. *Dublino*, 413 U.S. 405, 421 (1973); *Columbia Broadcasting System* v. *Democratic National Committee*, 412 U.S. 94, 121 (1973). The Comptroller is charged with the execution of the national banking laws. *See* 12 U.S.C. 1, 9, 26, 93a, 161(a), 481, 482, 1818 *passim*. With respect to our argument concerning the 1980 and 1982 deregulation acts (*infra* at pp. 18-22), the Comptroller is a member of DIDC—the Depository Institutions Deregulation Committee established to carry out deregulation. 12 U.S.C. 3502 (App. H at 70a). *Second*, at least with respect to the Depository Institutions Deregulation Act of 1980 and its 1982 amendment (see p. 18, *infra*), the Comptroller was an active participant in the design of the legislation and has played a pivotal role in setting the DIDC machinery in motion. *See Miller* v. *Youakim*, 440 U.S. 125, 144 (1979). *Third*, where, as here, a body of law is complex and presents a risk of misstep, the Court has given even greater deference to the expertise of the agency required to interpret it. *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 87 (1975); *see also Merrill* v. *Federal Open Market Committee*, 516 F. Supp. 1028, 1032 n.11 (D.D.C. 1981).

after full disclosure, finds the price terms (including the NSF charge) acceptable, if not attractive, in the marketplace. *Indeed, this prohibition may apply even if accounts are offered at prices in line with or less than prevailing market prices.* This Court held in *Franklin* that "the National Bank Act authorizes national banks to receive deposits *without qualification or limit.*" 347 U.S. at 376. The pricing limitation imposed below is therefore in conflict with federal law.

Second, the decision below impairs the pricing and marketing flexibility needed to attract deposits. The national banking system depends, as this Court observed in *Franklin*, "upon the success [of national banks] in attracting private deposits." *Id.* at 375. In attracting deposits, a national bank may determine that a deposit account with lower charges for some services and higher charges for other services will attract deposits. For example, it might determine that a deposit account with a lower maintenance charge and higher NSF charges will be attractive to a potential class of customers.[9] The decision below denies the bank the right to offer such an account even to willing customers. Instead, the decision allows a plaintiff to isolate a single feature of the account and to impose on it a cost-benefit requirement without regard to the costs and benefits of the entire account. Plaintiff seeks to force the bank, in order to earn the same revenue on the account, to offer a package with prices *different* from those it determines will attract deposits. If "[m]odern competition for business finds advertising one of the most usual and useful of weapons," as this Court observed in *Franklin*, then flex-

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[9] A checking account is a single product, governed by a single agreement, comprised of a package of features with respect to interest and service charges, including typically a maintenance charge, a per-check charge, a minimum balance credit, a check printing charge, a returned check charge, an overdraft charge, and a stop payment charge, among others.

ibility in price competition is of equal, if not paramount, importance.

Since the bank deregulation acts of 1980 and 1982, the need for pricing flexibility is all the greater (see pp. 18-22, *infra*). The Comptroller's interpretive regulation states:

> deregulation, including the lifting of interest rate ceilings on numerous types of accounts, underscores the need for national banks to have *flexibility* in the establishment of deposit account service charges so that they may continue to pay depositors market rates of interest. * * * The safety and soundness of banks depends in significant part on their ability to devise price structures appropriate for their needs. * * * *It is the position of the Office that banks should have the ability to set service charges to encourage or discourage the use of certain services in line with the bank's goals and corporate requirements.*

(App. I at 78a-79a). To deny national banks the pricing flexibility needed to identify potential markets and to price deposit products to attract customers in those markets is an impermissible restriction on the federal power to attract deposits, just as the advertising restriction in *Franklin* impermissibly restricted that power.

Third, although state regulation is not needed to supplant price regulation by the market, it is important to stress that the "regulatory" scheme at issue imposes a number of extraordinary burdens not found in ordinary rate-making schemes. The decision below permits class action suits against banks to be filed in any court of general jurisdiction in any county in the state. Multiple suits on the same charge are thus permitted, as are multiple suits on different charges with overlapping cost issues. There are, for example, six separate purported class action suits pending against Crocker, filed in two different counties, that challenge its returned item, overdraft, and other charges (see note 2, *supra*). Various

plaintiffs have already begun to whipsaw banks by arguing that all or most cost items are relevant to some *other* charge in some *other* case, thereby decreasing the cost of the charge challenged in each case. There is no guarantee, when all service charges are eventually litigated for any given time period chosen by individual plaintiffs, that all cost items will be recognized and recovered. The risk of inconsistent findings is evident, as is the risk of inconsistent definitions of undefined terms like "cost" and "unconscionable." [10] Common law courts are simply not equipped, as are utility-regulating agencies with comprehensive and unified rate-making powers, to minimize or eliminate these extraordinary burdens.

Worse, plaintiff seeks, as stated, artificially to isolate a single feature of the integrated deposit account and to force retroactive refunds of that charge. In the various NSF cases against Crocker alone, plaintiffs seek many millions of dollars in refunds, reaching back to 1973. If plaintiffs prevail, Crocker will be forced to refund substantial sums, but will be unable to recover the lost revenue by retroactively adjusting other charges. Under usual rate-making procedures, this problem is solved by establishing price terms in advance and providing the regulated entity a guaranteed return on investment. In contrast, under the scheme plaintiff advocates, a national bank must grit its teeth through years of multiplicitous and prolix litigation in different courts, all the while accruing massive potential liability, before it will learn, after the fact, whether its charges for any given time period were valid.

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[10] The decision below announced no standards for determining "cost." Plaintiffs argue for marginal cost. Defendants argue for fully allocated costs. And, there is also inherent uncertainty in defining "unconscionability," a problem even Perdue's counsel characterized below as "like trying to nail a blob of jelly to a wall" (Petition for Hearing in California Supreme Court at 13).

2. *The Exclusivity of the Comptroller's Power to Review Pricing by National Banks*

To assure the safety and soundness of the national banking system, the National Bank Act confers comprehensive review and enforcement powers on the Comptroller. These include the power to issue, to withhold, and to suspend charters of national banking associations; to conduct examinations of the operations of each association respecting the safety and soundness of its operations and compliance with applicable law; and to issue cease and desist orders to enjoin unsound practices. *See* 12 U.S.C. 1, 9, 26, 93a, 161(a), 191, 201-211, 481, 504, 1812, 1817, 1818, 1821(c), 1972; *Comptroller's Handbook For National Bank Examiners* § 1.1 at 1 (1977) ("*Handbook*") (App. J at 87a).

Periodic bank examinations are one of the Comptroller's most important means for assuring the safety and soundness of national banks. During examinations, all significant operations of the association, including the revenue base and the bank's program "to retain and expand the bank's deposit base," are reviewed (App. J at 89a). Service charges are reviewed because they must be "established with consideration of their impact on the financial health and profitability of the bank" (App. I at 84a). Based on the examination, the Comptroller may seek to require a national bank to modify its pricing or other practices (App. J at 87a-88a). The report of examination is confidential and may not be disclosed in any manner. 12 C.F.R. 7.6025(c) (1985).[11]

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[11] The Comptroller recognizes his authority and responsibility "to deal with instances of unacceptable pricing," and the interpretive regulation states "the Office will continue to review all banking practices, primarily through its examination process, and to take appropriate action when warranted" (App. I at 82a, 84a). The regulation anticipates that such instances will rarely arise and that the market itself will regulate the amount of service charges as financial institutions compete for deposits (App. I at 80a).

The comprehensiveness of the "visitorial powers" of the Comptroller is made clear in Section 484 of the Act, which provides that the Comptroller's review powers are exclusive:

> No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

12 U.S.C. 484.

The Comptroller, Congress, and the courts have uniformly construed Section 484 as precluding state actions to review bank compliance with state law. The Comptroller so ruled in 12 C.F.R. 7.6025(b) (1985). Congress made this plain in the original Section 484 and in a 1982 amendment. Before 1982, the Comptroller's visitorial authority was unqualified. The 1982 amendment created a limited exception to Section 484, permitting state officials to review the records of a national bank "*solely* to ensure compliance with applicable State unclaimed property or escheat laws. . . ." Pub. L. 97-320, 96 Stat. 1469, 1521, *codified at* 12 U.S.C. 484(b). *Accord* S. Rep. No. 536, 97th Cong., 2d Sess. 29 (1982). Similarly, the courts have regularly held, insofar as a national bank is concerned, that enforcement of state law (with minor exceptions not relevant here) is exclusively the province of the Comptroller and that any attempt directly to enforce such state law under state authority is preempted. *Pennsylvania Bankers Ass'n* v. *Commonwealth, Bureau of Consumer Protection*, 58 Pa. Commw. 170, 427 A.2d 730, 732 (1981) (state enforcement of state bank collection law preempted by § 484); *National State Bank, Elizabeth, N.J.* v. *Long*, 630 F.2d 981, 988-89 (3d Cir. 1980) (state enforcement of New Jersey anti-redlining statute preempted by § 484).

Despite the pervasive federal power to review bank service charges, the court below held that state courts

have "dual jurisdiction" to review and to modify the pricing structure of a national bank's services.[12] To be sure, there is a history of dual regulation of some aspects of banking in this country (App. A at 27a). But where review and modification of the service charge structure of a national bank are concerned, there is room for only one regulator. *First*, Section 484 expressly provides that only the Comptroller shall have access to the data needed to regulate.[13] *Second*, as stated, only the Comptroller has the authority to seek enforcement of any valid state law (*Long, supra*; *Pennsylvania Bankers Ass'n, supra*). *Third*, after the national bank examiners review a national bank's service charges and decide *not* to seek modification, a state court may not order a reduction in revenue without impermissibly altering the calculus on which the examination was made. *White Mountain Apache Tribe* v. *Bracker*, 448 U.S. 136, 149 (1980) (state action preempted where it would upset the "federal calculus" for determining revenues); *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151, 178 (1978) (federal decision *not* to regulate preempts state attempt to regulate). Such alterations can nullify the Comptroller's determination concerning the safety and soundness of the financial operations of the bank. Moreover, if retroactive refunds are ordered, several years of bank examinations can be upset,

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[12] Contrary to the opinion below, neither Crocker nor the Comptroller have ever argued against the dual system of banking regulation (App. A at 34a). Rather, they have argued that state *price* regulation is not permitted.

[13] Recognizing the force of Section 484, the court below allowed that Section 484 might restrict the ability of plaintiff "to examine records by way of discovery, or to subpoena such records at trial" (App. A at 21a n.21), but held that the action itself would not be preempted, only plaintiff's methods of proof. This ruling, however, eviscerates the exclusivity of the Comptroller's power to examine bank-wide operations by nonetheless authorizing inquiries by state courts into bank-wide financial operations, and conflicts with the decisions in *Pennsylvania Bankers Ass'n* and *Long, supra*.

especially where, as here, vast sums are sought.[14] *Fourth*, a national bank cannot present the results of the federal examination as evidence in state court by virtue of the confidentiality rule of 12 C.F.R. 7.6025(c). This means that a national bank would be powerless to explain to a state court the approval or modification of its fee structure by federal authority. Indeed, federal authorities could seek to require a national bank *to increase* its service charges and, under Section 7.6025(c), the bank could not so advise the state court.

For these reasons, insofar as the review and modification of a national bank's service charge structure is concerned, Congress has necessarily preempted state jurisdiction and made the Comptroller the exclusive regulator. Dual regulation of deposit account price terms "stands as an obstacle" to the statutory duty of the Comptroller and must yield. *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941); *see also Conference of Federal Savings & Loan Ass'ns* v. *Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980).

3. *The Federal Requirement to Price to Discourage NSF Checks*

Pursuant to the Comptroller's plenary authority to require sound banking practices, 12 U.S.C. 481, the Comptroller has directed that national banks set their NSF charges sufficiently high to deter the writing of NSF checks. Since 1977, Section 301.1 of the Comptroller's *Handbook* has expressly provided that "[o]verdraft charges should discourage frequen[t] usage" (App. J at 91a). Similarly, the Comptroller's interpretive regulation states, "it has been the Office position that service charges should discourage customers from frequently writing checks in amounts greater than their account balances" (App. I at 83a).

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[14] *See City of Burbank* v. *Lockheed Air Terminal*, 411 U.S. 624, 639 (1973); *Maryland* v. *Louisiana*, 451 U.S. 725, 749-52 (1981); *New Mexico* v. *Mescalero Apache Tribe*, 462 U.S. 324, 338-340 (1983) (all preempting state law in analogous circumstances).

This has two preemptive effects. *First*, after a national bank has tried to comply with the federal mandate by setting its NSF charges at levels that are high enough to discourage overdrafts, a state court should not be permitted, after the fact, to substitute its judgment and to order massive refunds. Such second-guessing will deter national banks from seeking to comply with the federal requirement in the first place, and thus "stands as an obstacle" to the federal requirement. *See Hines* v. *Davidowitz*, 312 U.S. at 67; *Capital Cities Cable, Inc.* v. *Crisp*, —— U.S. ——, 104 S. Ct. 2694, 2707 (1984).

Second, after a federal bank examiner has reviewed the NSF charges of a national bank for compliance with the federal requirement of Section 301.1 and decided not to disturb them, a state court cannot order a reduction in those charges without nullifying the federal determination. Yet this is precisely what the decision below expressly contemplates (App. A at 34a n.42). As before, this impermissibly intrudes into a domain reserved by Congress to federal authority.

4. *The Federal Deregulation Acts*

The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, and the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469, establish a significant federal banking policy—the price deregulation of all deposit accounts at all federally insured institutions. These Acts require financial institutions to compete for deposits on the basis of price and to pay market interest rates on deposits.

Before the 1980 Act, Regulation Q and related provisions, 12 C.F.R. 217.7, 329.6, 526.3 (*repealed* 1980), had prohibited national banks and federally insured savings and loan associations from paying more than 5¼% and 5½% interest, respectively, on short term time deposits of less than $100,000. By 1979, however, this ceiling, which was substantially lower than rates otherwise

available, had produced a severe liquidity problem among the nation's financial institutions. This problem was "disintermediation"—the rapid exodus of deposits from regulated institutions into "money-market" funds paying market rates of interest and interest-bearing NOW accounts. *See* S. Rep. No. 368, 96th Cong., 1st Sess. 3-5 (1979).[15]

To meet this mounting problem, the 1980 Act established the Depository Institutions Deregulation Committee ("DIDC") and directed DIDC to phase out all price regulation of interest rates paid by national banks and other affected financial institutions. This was to be done "as rapidly as economic conditions warrant" and with "due regard for the safety and soundness of depository institutions." 12 U.S.C. 3503 (App. H at 71a). The 1980 Act also authorized federal institutions to offer interest-bearing checking accounts (NOW accounts), 12 U.S.C. 1832(a) (App. H at 74a-75a), which had previously been prohibited. The Act adopted a national policy of requiring interest rates on deposit accounts to be set by the marketplace, for as Senator Proxmire stated in introducing the 1980 Act, "the market is the most efficient mechanism we have to allocate resources in our economy." 125 Cong. Rec. S7730 (daily ed. June 14, 1979).[16]

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[15] These conclusions concerning Regulation Q and NOW accounts had been reached earlier by the President's Inter-Agency Task Force on Deposit Interest Rate Controls and Housing Credit. *See* Message from President Carter to the House of Representatives Transmitting Recommendations for Comprehensive Financial Reform Legislation, H. Doc. 96-129, 96th Cong., 1st Sess. (May 22, 1979).

[16] *Accord* S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979); 125 Cong. Rec. H2506 (daily ed. May 1, 1979) (remarks of Rep. St Germain); *Depository Institutions Deregulation Act of 1979, Part II: Hearings Before the Subcomm. on Fin. Institutions of the Senate Comm. on Banking, Housing and Urban Affairs*, 96th Cong., 1st Sess. 89, 97 (1979) (testimony of Comptroller). For similar comments concerning the 1982 Amendment, *see Competition and Conditions in the Financial System, Part I: Hearings Before the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 51, 55 (1981) (remarks of Vice Cha., Bd. of Gov.

Significantly, Congress repeatedly recognized that if financial institutions were to increase their interest rates on deposits, they also would have to increase their service charges on deposits. As Senator Cranston said, for example, in the Senate Report, "if institutions are going to pay higher interest rates . . . , institutions are going to have to charge more for the services they offer and the money they lend." S. Rep. No. 368 at 39. *Accord* 125 Cong. Rec. S7726 (daily ed. June 14, 1979) (Senator Cranston). Senator Morgan likewise stated that institutions would have to "pass these [interest] costs on in the form of service charges . . . ." S. Rep. No. 368 at 37-38. In the House, Representative Annunzio "time and time again . . . pointed out . . . that while consumers [might earn more interest] they would also face higher interest rates on loans and additional service charges." BNA, *Daily Rep.*, No. 3, Jan. 6, 1984 at A-10.

In light of the necessary relationship between interest and service charges, Crocker and the Comptroller argued below that state price limits on service charges stand as an "obstacle to the accomplishment and execution of the full purposes and objectives" to pay higher interest and are thus preempted. *Hines* v. *Davidowitz*, 312 U.S. at 67.[17] The court below recognized that "Congress clearly

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of the Fed. Res. System); *id.* at 31, 33 (remarks of Donald T. Regan, Secretary of the Treasury).

[17] Appellant also argued below that Congress directed DIDC to weigh, in deciding the pace of deregulation, the potential impact of each incremental step on the "safety and soundness" of affected institutions against the goal of achieving deregulation "as rapidly as economic conditions warrant." 12 U.S.C. 3503(a) (App. H at 71a). Congress thus entrusted to DIDC a task of delicate balancing. Crocker argued that any state limitation on service charge income of affected institutions in California would impermissibly interfere with this balancing, especially here, where plaintiff seeks to force the institution to charge *far* less than market rates. To permit such limitations on a major component of income would, in effect, reweigh the balance struck by DIDC and would undermine the judgments drawn by DIDC concerning the safety and soundness of national banks and the desirable pace of deregulation. In such circumstances, state laws have been regularly held preempted.

anticipated that banks would be able to charge fees for depositor services sufficient to recover the cost of such services" (App. A at 35a). It held, however, that the state laws in question permitted the recovery of "the cost" of the services and a "reasonable profit" (*ibid.*), that Congress had mandated nothing more, and that the Comptroller's determination that greater flexibility is needed is "palpably erroneous" (App. A at 28a).

This was error. *First*, although the decision below purports to allow recovery of all costs, in fact, it permits the artificial isolation of a single feature of the integrated deposit account and the imposition of a cost-benefit requirement solely on that feature, without regard to the costs and benefits of the entire account. To isolate artificially a single feature in this way can push the overall economics of the account into a loss position. The decision below does *not*, therefore, necessarily allow recovery of all costs. It is the totality of costs that determines how much interest can be paid on the account.

Second, in order to pay *market* interest rates on deposits, a bank must be able to earn *market* service charges on deposits. Otherwise, the bank will be at a competitive disadvantage in its ability to pay market interest. The decision below, however, holds that even a service charge priced *at market*, as here (App. A at 13a n.14), can be set aside (App. A at 11a-13a). This stands as an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress" and is therefore preempted. *Hines* v. *Davidowitz*, 312 U.S. at 67.[18]

New Mexico v. *Mescalero Apache Tribe*, 462 U.S. at 340; *White Mountain Apache Tribe* v. *Bracker*, 448 U.S. at 149. Although the court did not address this argument, it was presented below and thus preserved for this Court's review.

[18] The decision below also made a point of the fact that Congress expressly preempted certain usury laws but did not expressly preempt state regulation of service charges (App. A at 32a). In fact, Congress cut free the only two types of price regulations then affecting depository institutions—Regulation Q and state usury laws—so that both costs and revenues would be subject to the inter-

Third, the decision below seeks to impose state law limitations on service charges, contrary to the Comptroller's affirmative decision in his interpretive regulation that, in light of the deregulation acts, such charges should ordinarily be regulated by competitive market forces and subject to agency review (through the national bank examination process) only in "instances of unacceptable pricing" (App. I at 82a). Where, as here, the failure of federal officials " 'affirmatively to exercise their full authority takes on the character of a ruling that no such regulation is appropriate or approved pursuant to the policy of the statute,' States are not permitted to use their police power to enact such a regulation." *Ray* v. *Atlantic Richfield Co.*, 435 U.S. at 178 (citations omitted). Thus, the Comptroller's decision *not* to regulate service charges except in extraordinary circumstances preempts state regulation of those charges.

5. *The Need for Review*

These federal issues warrant review at this time. *First*, a formal interpretive regulation of the Comptroller of the Currency has been held invalid, indeed "palpably erroneous" (App. A at 28a). Without review, the

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active forces of the competitive market. *Although no provision of the Act expressly preempts any state limits on service charges, the clear understanding of Congress was that there were no such limits and no explicit preemption was necessary (as was necessary for state usury laws, which did exist).* In fact, as stated, Congress expressly recognized that service charges would go up to allow payment of market interest rates on deposits. Moreover, the passage from the Senate Report cited by the court below (App. A at 32a n.37) does *not* hold that Congress intended that service charges on deposits should be governed by state law, but merely holds that certain loan-related charges were not preempted.

The court below also argued that a uniform requirement of "reasonable" rates on all industries was not, in effect, a form of regulation (App. A at 36a). This Court, however, has repeatedly held that common-law actions, such as tort actions, are forms of state regulation that may be preempted. *San Diego Bldg. Trades Council* v. *Garmon*, 359 U.S. 236, 247 (1959); *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 584 (1981).

regulation will not be effective in California but will presumably continue to be accepted as valid elsewhere in the country. This gap in uniform construction on an important issue of federal banking law warrants review.

Second, the decision below squarely conflicts with the decision in a virtually identical case in New York, which held that federal law preempts any challenge to the amount of national bank service charges. *Jacobs* v. *Citibank, N.A.*, 61 N.Y.2d 689, 462 N.E.2d 1182, 1183, 474 N.Y.S.2d 464 (Ct. App. 1984) (upholding an earlier version of 12 C.F.R. 7.8000 and dismissing challenge to NSF charge). Although the court below tried to distinguish *Jacobs* on the ground that it arose on summary judgment rather than, as here, a motion to dismiss, the controlling issue in both cases is a legal issue of federal preemption. The two holdings plainly are in conflict on that issue. The decision below also conflicts with decisions preempting state enforcement of consumer laws in light of the exclusive visitorial powers of the Comptroller under 12 U.S.C. 484. *Pennsylvania Bankers Ass'n* v. *Commonwealth, Bureau of Consumer Protection*, 58 Pa. Commw. 170, 427 A.2d 730, 732 (1981); *National State Bank, Elizabeth, N.J.* v. *Long*, 630 F.2d 981, 988-89 (3d Cir. 1980).

Third, there is an extraordinary need for certainty. In the wake of deregulation, considerable dispute has arisen concerning the power of financial institutions to increase their service charges to pay higher interest rates on deposits. Numerous lawsuits are pending nationwide challenging the service charges of various banks. In California alone, there are 28 such actions, 14 of which have been stayed pending the outcome of this appeal. Similar actions have been filed in Oregon, New York, and Alaska. The federal preemption issue is pivotal and dispositive in virtually all of these suits, at least as to all national banks and federally insured institutions. The need for certainty in the face of these disputes was the reason the Comptroller promulgated his interpretive regulation (App. I at 77a). That need per-

sists. Until the federal preemption issue is authoritatively resolved, extraordinary sums in potential liability will accrue to the nation's banking system.[19]

Appellee will no doubt argue that there will be time enough to review the *Perdue* decision after it has run its course on remand.[20] This approach, however, would

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[19] The amount of service charge income of Crocker and Bank of America alone is, even according to NSF plaintiffs, "well over $200,000,000 *annually*." Amicus Brief to California Supreme Court of Certified Class Plaintiffs in NSF Litigation at 6.

[20] An otherwise non-final state court judgment is immediately reviewable where: (1) "the federal issue has been finally decided"; (2) the party seeking review "might prevail on the merits on non-federal grounds"; (3) reversal by this Court "would be preclusive of any further litigation on the relevant cause of action"; and (4) "refusal immediately to review the state-court decision might seriously erode federal policy . . . ." *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469, 482-83 (1975).

All four factors are present here. The federal issue—preemption of state price regulation of deposit account service charges—has been directly addressed and "finally decided" below. Appellant "might prevail" after remand on non-federal grounds, thereby cutting off this Court's ability to review the substantial federal issues presented here. Reversal by this Court "would be preclusive" of further litigation on the question of state-court regulation of deposit account service charges. And refusal to grant immediate review would "seriously erode" the congressional policy requiring federally insured financial institutions to set the amount of those charges at market levels, and would undermine the clear mandate of the 1980 and 1982 deregulation acts and the Comptroller's interpretive regulation. As stated in *Cohn*, to deny immediate review would only invite " 'the mischief of economic waste and of delayed justice,' " 420 U.S. at 478 (citation omitted).

Moreover, denial of immediate review in this case poses the real danger that this Court will be denied the "opportunity to pass on the federal issue and as a result 'there would remain in effect the unreviewed decision of the State Supreme Court' holding that the California statute" was not preempted. *Southland Corp.* v. *Keating*, 405 U.S. 1, 6 (1984) (citation omitted). Denial of immediate review would open the door to prolonged and multiplicitous litigation, in direct contravention of the "core purposes," *id.* at 7, of the federal rights appellant seeks to vindicate. *See also Belknap* v. *Hale*, 463 U.S. 491, 498 n.5 (1983) ("our grant of the petition for certiorari

deny the essence of appellant's federal claim, for it would require appellant to submit to the very process that burdens the federal right. Regardless of how strong their case, few, if any, financial institutions can be expected to weather the years of litigation and trial risk on the state law issues created by the decision below, all the while accruing large potential liability, to preserve a federal claim for ultimate review here. The applicable standards are uncertain. The realities of litigation do not favor banks. NSF charges are unpopular. The sums at issue are large. The cost of litigation and extensive bank-wide cost-accounting studies is substantial. These burdens and risks support resolution of the federal claims at this point, for those claims, if sustained, are dispositive of the relevant causes of action. The federal claims have been finally and authoritatively rejected by the California courts. If the federal right is to be effectively vindicated, there is unusual need for review at this time.

Respectfully submitted,

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. . . was not infirm because of the lack of a final judgment; and our jurisdiction to affirm or reverse . . . on the preemption issue, an issue which is not by any means frivolous, is clear").

Indeed, the right of appeal from a pretrial ruling rejecting a claim of federal preemption is so clear-cut that this Court has at times asserted jurisdiction without even discussing the issue. *See, e.g., Fidelity Savings & Loan Ass'n* v. *De La Cuesta*, 458 U.S. 141 (1982); *Third National Bank* v. *Impac Ltd., Inc.*, 432 U.S. 312 (1977).

85-1035

No. _____

Supreme Court, U.S.
FILED
DEC 16 1985
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

APPENDIX TO JURISDICTIONAL STATEMENT

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TABLE OF CONTENTS

	Page
Appendix A—Opinion of the Supreme Court of California	1a
Appendix B—Judgment of Dismissal	38a
Appendix C—Opinion of the California Court of Appeal	40a
Appendix D—Complaint	52a
Appendix E—Order Denying Rehearing in the Supreme Court of California	65a
Appendix F—Notice of Appeal	66a
Appendix G—12 U.S.C. §§ 24, 484	68a
Appendix H—12 U.S.C. §§ 3501-3505, 1832	69a
Appendix I—Interpretive Rulings of the Comptroller of the Currency, *codified at* 12 C.F.R. § 7.8000	76a
Appendix J—Excerpts from the *Comptroller's Handbook For National Bank Examiners*	87a
Appendix K—Cal. Civ. Code § 1670.5	103a
Appendix L—Briefs of Amicus Curiae Comptroller of the Currency in the Supreme Court of California	104a

APPENDIX A

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

S.F. 24591
(Super. Ct. No. 740351)

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

[Filed July 18, 1985]

Plaintiff filed this class action to challenge the validity of charges imposed by defendant Crocker National Bank for the processing of checks drawn on accounts without sufficient funds. (The parties refer to such checks as NSF checks and to the handling charge as an NSF charge.) He appeals from a judgment of the trial court entered after that court sustained defendant's general demurrer without leave to amend.

On July 3, 1978, plaintiff filed suit on behalf of all persons with checking accounts at defendant bank and a subclass of customers who have paid NSF charges to the bank.[1] The complaint first alleges a contract under which

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[1] The complaint refers to both "plaintiffs" and "defendants" in the plural. Perdue, however, is the only named plaintiff; the

the bank furnishes checking service in return for a maintenance charge.[2] It then asserts that "It is the practice of defendants to impose and collect a unilateral set charge for processing checks presented against plaintiffs' accounts when such accounts do not contain sufficient funds to cover the amount of the check." "Defendants have at various times unilaterally increased the NSF charge to an amount the defendants deemed appropriate, without reference to any criteria, and defendants imposed and collected the said increased amount without any explanation or justification by defendants to plaintiffs." At the time of filing of the suit, the charge was $6 for each NSF check, whether the check was honored or returned unpaid, even though "the actual cost incurred by the defendants in processing an NSF check is approximately $0.30."

The bank requires each depositor to sign a signature card which it uses "to determine and verify the authenticity of endorsements on checks". A copy of the signature card is attached as an exhibit to the complaint and reproduced in an appendix to this opinion. In extremely small (6 point) type, it states that the undersigned depositors "agree with Crocker National Bank and with each other that . . . this account and all deposits therein shall be . . . subject to all applicable laws, to the Bank's present and future rules, regulations, practices and

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others are unidentified members of the class. The complaint names Crocker National Bank and Does 1-100 as defendants, but the "Doe" defendants have not been served or identified. We refer to both parties in the singular.

[2] Paragraph 7 states: "Defendants offer said checking services in exchange for a promise by plaintiffs to pay a predetermined charge set by defendants [hereafter called the maintenance charge.] Plaintiffs, at the commencement of the checking account agreed to pay said maintenance charge, or to maintain a minimum balance in their checking account or some similar arrangement, unless such charge was waived. . . ."

charges, and to its right of setoff for the obligations of any of us." The card does not identify the amount of the charge for NSF checks, and the bank does not furnish the depositor with a copy of the applicable bank rules and regulations.[3]

On the basis of these allegations, plaintiff asserts five causes of action: (1) for a judicial declaration that the bank's signature card is not a contract authorizing NSF charges; (2) for a judicial declaration that such charges are oppressive and unconscionable; (3) to recover damages for unjust enrichment derived from the bank's collection of illegal NSF charges; (4) to enjoin alleged unfair and deceptive practices—the bank's failure to inform customers of the contractual nature of the signature card, and its practice of waiving NSF charges as to certain preferred customers; and (5) to recover the difference between the NSF charges and defendant's actual expenses in processing NSF checks on the theory that the charges represent an unreasonable attempt to fix liquidated damages.

Defendant filed general and special demurrers to each of the asserted causes of action. The superior court sustained the general demurrers and, taking notice of the fact that plaintiff had filed three previous complaints in another action raising similar issues,[4] denied leave to amend. Plaintiff appeals from judgment for defendant.

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[3] Financial Code section 865.2, effective July 1, 1977, requires banks to make information about bank charges available to the public in an area of the bank open to the public. The complaint does not state whether defendant complied with this section.

[4] Plaintiff Perdue and co-plaintiff Ralph Abascal filed a complaint against Crocker National Bank on March 15, 1977, raising issues similar to those of the present complaint. (S.F. Super. Ct. No. 720-309.) After the court sustained demurrers with leave to amend, Perdue and Abascal filed a first, and then a second amended complaint. On June 15, 1978, counsel for Perdue and counsel for Abascal severed their association, and counsel for Perdue filed the

Plaintiff's third alleged cause of action is derivative; its charge of unjust enrichment depends upon a finding pursuant to some other cause of action that the NSF charges were invalid or excessive. This cause of action raises no issues for decision in the present appeal. The other four alleged causes of action, however, present independent and substantial issues. We review each in turn, applying the established principle that a demurrer "admits the truth of all material factual allegations in the complaint . . .; the question of plaintiff's ability to prove those allegations, or the possible difficulty in making such proof does not concern the reviewing court." (Alcorn v. Anbro Engineering Inc. (1970) 2 Cal.3d 493, 496; Committee on Children's TV, Inc. v. General Foods Corp. (1983) 35 Cal.3d 197, 213-214.)

I. *Plaintiff's first cause of action: whether the signature card is a contract authorizing NSF charges.*

The complaint alleges that "The signature card prepared by the defendants does not identify the amount of any charge to be paid by the plaintiffs for processing NSF checks and is not an agreement for such payment. The card does not constitute mutual assent to NSF charges in any particular sum or at all and accordingly is not a contract conferring authority to do the acts complained of herein." "Based upon the language of the signature card, the plaintiffs believed and expected that the signature card was intended as a handwriting example for purposes of identification and verification only." Plaintiff therefore seeks a judicial declaration "as to whether the signature card is a valid or enforceable contract and . . . a lawful basis for the imposition of the NSF charge."

The cases unanimously agree that a signature card such as the Crocker Bank card at issue here is a con-

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present action. The superior court subsequently denied a petition to coordinate the various actions attacking NSF check charges, and dismissed Perdue as a coplaintiff in action No. 720-309.

tract. "The bank is authorized to honor withdrawals from an account on the signatures authorized by the signature card, which serves as a contract between the depositor and the bank for the handling of the account." (Blackmon v. Hale (1970) 1 Cal.3d 548, 556; Bullis v. Security Pac. Nat. Bank (1978) 21 Cal.3d 801, 811-812.) Other California decisions (see Hoffman v. Security Pacific Nat. Bank (1981) 121 Cal.App.3d 964, 969; Larrus v. First National Bank (1954) 122 Cal.App. 2d 884, 889-890) and decisions of other states (see, e.g., In re Estate of Cilvik (Pa. 1970) 267 A.2d 836, 838, fn. 2) also view the signature card as a contract.

Plaintiff does not seriously dispute this proposition. His complaint alleges that the depositors "agreed to pay [the bank's] maintenance charge . . ." in return for checking privileges, and one could infer that they agreed to do so by affixing their signatures to the card. Complaints filed by plaintiff in an earlier action stated expressly that the signature card was a contract.[5]

Plaintiff argues, however, that even if a signature card is a contract to establish a checking account, it is not a contract authorizing NSF charges. He contends that the contract is illusory because it permits the bank to set and change the NSF charges at its discretion, and without assent from the customer except such as may be inferred from the fact that the customer does not cancel his account after the bank posts notice of its rates.[6]

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[5] The parties dispute whether the language in the complaints filed in action S.F. Super. Ct. No. 720-309 are binding upon plaintiff in the present case. It is well settled that a court may consider language of prior complaints in the same action in ruling on a demurrer (Reichert v. General Ins. Co. (1968) 68 Cal.2d 822, 836), but the cases do not discuss the effect of a prior complaint in a different action.

[6] Financial Code section 865.4, subdivision (b) (1) requires a bank to give customers 15 days' notice of any change in charges imposed on bank accounts.

Plaintiff relies on the rule that "[a]n agreement that provides that the price to be paid, or other performance to be rendered, shall be left to the will and discretion of one of the parties is not enforceable." (Automatic Vending Co. v. Wisdom (1960) 182 Cal.App.2d 354, 357.) That rule, however, applies only if the total discretion granted one party renders the contract lacking in consideration. (See *ibid.*) If there are reciprocal promises, as in the present case, the fact that the contract permits one party to set or change the price charged for goods or services does not render the contract illusory. Thus in Cal. Lettuce Growers v. Union Sugar Co. (1955) 45 Cal.2d 474, the court upheld a contract permitting the buyer of sugar beets to set the price to be paid. The buyer did not have arbitrary power, the court explained, because "where a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing." (P. 484; see Automatic Vending Co. v. Wisdom, *supra*, 182 Cal.App.2d 354, 358 and cases there cited; cf. Civ. Code, § 1611; Cal. U. Com. Code, § 2305; 1 Corbin, Contracts (1963 ed.) § 98.) Likewise, "a contracting party's discretionary power to vary the price or other performance does not render the agreement illusory if the party's *actual* exercise of the power is reasonable." (Powell v. Central Cal. Fed. Sav. & Loan Assn. (1976) 59 Cal.App.3d 540, 549, italics original; see Vanguard Investments v. Central Cal. Fed. Sav. & Loan Assn. (1977) 68 Cal.App.3d 950, 958; Frankini v. Bank of America (1939) 31 Cal.App.2d 666, 676.)

The recent decision in Lazar v. Hertz Corp. (1983) 143 Cal.App.3d 128, offers an analogy to the present litigation. Hertz' car rental agreement permitted it to determine unilaterally the price charged for gas used to fill the tanks of returned rental cars. Plaintiff's suit alleged that Hertz fixed unreasonably high prices, in

breach of its duty of good faith and fair dealing. Discussing this cause of action, the court said that "[t]he essence of the good faith covenant is objectively reasonable conduct. Under California law, an open term in a contract must be filled in by the party having discretion within the standard of good faith and fair dealing." (P. 141.)

We conclude that plaintiff here is not entitled to a judicial declaration that the bank's signature card is not a contract authorizing NSF charges. To the contrary, we hold as a matter of law that the card is a contract authorizing the bank to impose such charges, subject to the bank's duty of good faith and fair dealing in setting or varying such charges. Plaintiff may, upon remand of this case, amend his complaint to seek a judicial declaration determining whether the charges actually set by the bank are consonant with that duty.

II. *Plaintiff's second cause of action: whether the bank's NSF charges are oppressive, unreasonable, or unconscionable.*

Plaintiff's second cause of action alleges that the signature card is drafted by defendant bank which enjoys a superior bargaining position by reason of its greater economic power, knowledge, experience and resources. Depositors have no alternative but to acquiesce in the relationship as offered by defendant or to accept a similar arrangement with another bank.[7] The complaint alleges that the card is vague and uncertain, that it is unclear whether it is intended as an identification card or a contract, that it imposes no obligation upon the bank, and permits the bank to alter or terminate the relationship at

[7] Defendant and other banks now offer some depositors an arrangement under which, for a fee, the bank will treat NSF checks up to a certain amount as credit card transactions, and honor such checks. We do not know whether such arrangements were available when plaintiff filed his complaint.

any time.[8] It then asserts that "The disparity between the actual cost to defendants and the amount charged by defendants for processing an NSF check unreasonably and oppressively imposes excessive and unfair liability upon plaintiffs." Plaintiff seeks a declaratory judgment to determine the rights and duties of the parties.

Plaintiff's allegations point to the conclusion that the signature card, if it is a contract, is one of adhesion. The term contract of adhesion "signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." (Neal v. State Farm Ins. Co. (1961) 188 Cal.App.2d 690, 694; Graham v. Scissor-Tail, Inc. (1981) 28 Cal.3d 807, 817.) The signature card, drafted by the bank and offered to the customer without negotiation, is a classic example of a contract of adhesion; the bank concedes as much.

In Graham v. Scissor-Tail, Inc., *supra*, 28 Cal.3d 807, we observed that "To describe a contract as adhesive in character is not to indicate its legal effect . . . . [A] contract of adhesion is fully enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (Pp. 819-820, fn. omitted.) "Generally speaking," we explained, "there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. [Citations.] The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if

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[8] The depositor also has the right to terminate the relationship at any time, but lacks the right asserted by the bank to alter the relationship without terminating it.

consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' " (P. 820, fns. omitted.)[9]

In 1979, the Legislature enacted Civil Code section 1670.5, which codified the established doctrine that a court can refuse to enforce an unconscionable provision in a contract.[10] Section 1670.5 reads as follows: "(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. [¶] (b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be af-

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[9] The Court of Appeal decision in A & M Produce Co. v. FMC Corp. (1982) 135 Cal.App.3d 473, offers an alternative analytical framework. It treats "unconscionability" as the only basis for refusing to enforce a provision. (Graham v. Scissor-Tail, Inc., *supra*, 28 Cal.3d 807, spoke of "frustration of reasonable expectations" and "unconscionability" as alternative bases for refusing enforcement.) *A & M Produce* then divided the analysis of unconscionability into two elements—procedural and substantive. The procedural element included "oppression" arising from unequal bargaining power and "surprise" arising from the assertion of hidden and unexpected provisions. The substantive element involved consideration of whether the provision was one-sided, unreasonable, and lacked justification. (See 135 Cal.App.3d at pp. 485-487.)

Graham v. *Scissor-Tail, Inc.* comports somewhat more closely to the California precedent; *A & M Produce* conforms more closely to the Uniform Commercial Code and the cases decided under that code. Both pathways should lead to the same result.

[10] Section 1670.5 is based upon Uniform Commercial Code section 2-302, but expands coverage to include noncommercial contracts. For review of the legislative history of section 1670.5, see IMO Development Corp. v. Dow Corning Corp. (1982) 135 Cal.App.3d 451, 459-460.

forded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination."

In construing this section, we cannot go so far as plaintiff, who contends that even a conclusory allegation of unconscionability requires an evidentiary hearing. We do view the section, however, as legislative recognition that a claim of unconscionability often cannot be determined merely by examining the face of the contract, but will require inquiry into its setting, purpose, and effect.

Plaintiff bases his claim of unconscionability on the alleged 2,000 percent differential between the NSF charge of $6 and the alleged cost to the bank of $0.30.[11] The parties have cited numerous cases on whether the price of an item can be so excessive as to be unconscionable. The cited cases are from other jurisdictions, often from trial courts or intermediate appellate courts, and none is truly authoritative on the issue. Taken together, however, they provide a useful guide to analysis of the claim that a price is so excessive as to be unconscionable.

To begin with, it is clear that the price term, like any other term in a contract, may be unconscionable. (Patterson v. Walker-Thomas Furniture Co. (D.C.Ct. App. 1971) 277 A.2d 111, 113 and cases there cited (fn. 6); see Central Budget Corp. v. Sanchez (N.Y. City Civ. Ct. 1967) 279 N.Y.Supp.2d 391, 392; Merrel v. Research & Data, Inc. (Kan.Ct.App. 1979) 589 P.2d 120, 123 (dictum); Vom Lehn v. Astor Art Galleries, Ltd. (N.Y. Sup. Ct. 1976) 380 N.Y.Supp.2d 532, 541.) Allegations

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[11] The bank's briefs claim the alleged $0.30 cost is too low and plaintiff's briefs admit that a higher figure, but still $1 or less, might be more accurate. We do not, however, find in plaintiff's briefs a sufficiently clear concession to enable us to depart from the general principle that, in reviewing a judgment after the sustaining of a general demurrer without leave to amend, we must assume the truth of all material factual allegations in the complaint. (Alcorn v. Anbro Engineering, Inc., *supra*, 2 Cal.3d 493, 496.)

that the price exceeds cost or fair value, standing alone, do not state a cause of action. (Morris v. Capitol Furniture Co. (App. D.C. 1971) 280 A.2d 775 [100 percent markup over cost]; Patterson v. Walker-Thomas Furniture Co., *supra*, 277 A.2d 111, 114 [price alleged to be in excess of fair value]; Bennett v. Behring Corp. (S.D. Fla. 1979) 466 F.Supp. 689, 696-698 [price in excess of value].) Instead, plaintiff's case will turn upon further allegations and proof setting forth the circumstances of the transaction.

The courts look to the basis and justification for the price (cf. A & M Produce Co. v. FMC Corp., *supra*, 135 Cal.App.3d 473, 487), including "the price actually being paid by . . . other similarly situated consumers in a similar transaction." (Bennett v. Behring Corp., *supra*, 466 F.Supp. 689, 697, italics omitted.) The cases, however, do not support defendant's contention that a price equal to the market price cannot be held unconscionable. While it is unlikely that a court would find a price set by a freely competitive market to be unconscionable (see Bradford v. Plains Cotton Cooperative Assn. (10th Cir. 1976) 539 F.2d 1249, 1255 [cotton futures]), the market price set by an oligopoly should not be immune from scrutiny. Thus courts consider not only the market price, but also the cost of the goods or services to the seller (Frostifresh Corporation v. Reynoso (N.Y. Dist. Ct. 1966) 274 N.Y.Supp. 757; Toker v. Westerman (N.J. 1970) 274 A.2d 78), the inconvenience imposed on the seller (see Merrel v. Research & Data, Inc., *supra*, 589 P.2d 120, 123), and the true value of the produce [sic] or service (American Home Improvements, Inc. v. MacIver (N.H. 1964) 201 A.2d 886, 889).

In addition to the price justification, decisions examine what Justice Weiner in *A & M Produce* called the "procedural aspects" of unconscionability. (See *A & M Produce Co.*, *supra*, at p. 489.) Cases may turn on the absence of meaningful choice (Patterson v. Walker-

Thomas Furniture Co., *supra*, 277 A.2d 111, 113 and cases there cited), the lack of sophistication of the buyer (compare Geldermann & Co., Inc. v. Lane Processing, Inc. (8th Cir. 1975) 527 F.2d 571, 576 [relief denied to sophisticated investor) with Forstifresh Corporation v. Reynoso, *supra*, 284 N.Y.Supp.2d 757 [relief granted to unsophisticated buyers]) and the presence of deceptive practices by the seller (*ibid.;* Vom Lehn v. Astor Art Galleries, Ltd., *supra*, 380 N.Y.Supp.2d 532).

Applying this analysis to our review of the complaint at hand, we cannot endorse defendant's argument that the $6 charge is so obviously reasonable that no inquiry into its basis or justification is necessary.[12] In 1978 $6 for processing NSF checks may not seem exorbitant,[13]

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[12] In Jacobs v. Citibank, N.A. (1984) —— N.Y. ——, the New York Court of Appeals upheld a summary judgment for defendant bank in a suit attacking NSF check charges. In rejecting the claim that such charges were unconscionable, the court said that "[p]laintiffs have failed to show that they were deprived of a meaningful choice of banks with which they could do business and that the terms of these agreements with defendant were unreasonably favorable to the bank." (P. ——.)

While the New York court ruled on a motion for summary judgment, we rule upon a demurrer, and look only to plaintiff's allegations, not to the proof he had advanced to support those allegations. Plaintiff here has alleged that the charges imposed by defendant bank were excessive, and that similar arrangements would be imposed by other banks. Such allegations, which we must assume to be true, distinguish the New York decision.

[13] Defendant cites Merrel v. Research & Data, Inc., *supra*, 589 P.2d 120, which held a $5 fee imposed by merchants for NSF checks was a "modest" amount (p. 123) and not unconscionable. NSF checks pose a substantial inconvenience to a seller, who has been deceived into an involuntary extension of credit to a customer whose credit standing may not be very good. A bank, however, is not deceived. It checks the balance of the account, and may reject any overdraft. A fee reasonable to compensate the merchant for the cost, inconvenience, and risk of an NSF check may be excessive if exacted by a bank.

but price alone is not a reliable guide. Small charges applied to a large volume of transactions may yield a sizable sum. The complaint asserts that the cost of processing NSF checks is only $0.30 per check, which means that a $6 charge would produce a 2,000 percent profit; even at the higher cost estimate of $1 a check mentioned in plaintiff's petition for hearing, the profit is 600 percent.[14] Such profit percentages may not be automatically unconscionable, but they indicate the need for further inquiry.[15]

Other aspects of the transaction confirm plaintiff's right to a factual hearing. Defendant presents the depositor with a document which serves at least in part as a handwriting exemplar, and whose contractual character is not obvious. The contractual language appears in print so small that many could not read it. State law may impose obligations on the bank (e.g., the duty to honor a check when the account has sufficient funds (Allen v. Bank of America, *supra*, 58 Cal.App.2d 124, 127)), but so far as the signature card drafted by the bank is concerned, the bank has all the rights and the depositor all the duties. The signature card provides that the depositor will be bound by the bank's rules, regulations, practices and charges, but the bank does not furnish the depositor with a copy of the relevant documents. The bank reserves the power to change its practices and fees at any time, subject only to the notice requirements of state law.

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[14] The complaint does not state the market price for the service of processing NSF checks, although one might infer it is similar to defendant's price since plaintiff alleges that if he did not contract with defendant, he would be "forced to accept a similar arrangement with other banks." The complaint does not set a figure for the "fair" or "true" value or worth of the service.

[15] We observe that the bank charges the same fee whether it honors or rejects an NSF check. The fee, consequently, cannot be intended as compensation for the credit risk arising from paying such a check, or for the interest on the amount loaned.

In short, the bank structured a totally one-sided transaction. The absence of equality of bargaining power, open negotiation, full disclosure, and a contract which fairly sets out the rights and duties of each party demonstrates that the transaction lacks those checks and balances which would inhibit the charging of unconscionable fees. In such a setting, plaintiff's charge that the bank's NSF fee is exorbitant, yielding a profit far in excess of cost, cannot be dismissed on demurrer. Under Civil Code section 1670.5, the parties should be afforded a reasonable opportunity to present evidence as to the commercial setting, purpose, and effect of the signature card and the NSF charge in order to determine whether that charge is unconscionable.

III. *Plaintiff's fourth cause of action: whether the bank has performed acts of unfair competition.*

Business and Professions Code section 17200 defines "unfair competition" to include any "unlawful, unfair, or fraudulent business practice." This language is intended to protect consumers as well as business competitors; its prohibitory reach is not limited to deceptive or fraudulent conduct but extends to any unlawful business conduct. (Committee on Children's TV, Inc. v. General Foods Corp., *supra*, 35 Cal.3d 197, 209-210; Stoiber v. Honeychuck (1980) 101 Cal.App.3d 903, 927.)

The complaint charges two acts of unfair competition. First, it asserts that the "signature card is used in a manner which is unfair, deceptive and misleading, in that plaintiffs are led to believe that it is a signature card for identification purposes and the defendants treat the signature card, without disclosure of said fact, as the legal authority to impose the NSF charge on plaintiffs' checking accounts." Second, it asserts that "defendants arbitrarily and capriciously waive the NSF charge for preferred or commercial accounts," thus shifting the costs of processing NSF checks from those preferred customers to others whose accounts are charged.

Neither allegation is clear and precise. After reading paragraph 38, we are uncertain whether plaintiff contends that the signature card itself is deceptive, or whether he contends that the bank employs misrepresentations or other deceptive practices in presenting the card to the depositor. If the latter is plaintiff's contention, the complaint should set out the challenged representations or practices.

It is, of course, clear that if plaintiff can show that the card or the manner in which it is presented to the customer is deceptive and misleading, he can prove a cause of action for unfair competition. Since he seeks only injunctive relief under this cause of action, he need not show that he himself was misled; he need only prove that "members of the public are likely to be deceived." (Chern v. Bank of America (1976) 15 Cal.3d 866, 876; Committee on Children's TV, Inc. v. General Foods Corp., *supra*, 35 Cal.3d 197, 211.) Thus the defect in plaintiff's allegation is not one of substance, but only of lack of certainty. Such a defect would not justify the sustaining of a demurrer without leave to amend. (Minsky v. City of Los Angeles (1974) 11 Cal.3d 113, 118; La Sala v. American Sav. & Loan Assn. (1971) 5 Cal.3d 864, 876.)

Plaintiff's assertion in paragraph 39 that the bank arbitrarily waives NSF charges for some customers contains a more serious defect. Although price discrimination is often unlawful, depending upon the context of the act and the intent of the perpetrator (see the Unfair Practices Act, Bus. & Prof. Code, § 17000 et seq.), "arbitrary" price discrimination in itself is not necessarily illegal. This defect is one of substance; while plaintiff's accusation in paragraph 38 of deceptive and misleading practices describes acts of unfair competition, albeit in very general terms, his accusation of arbitrary waiver of NSF charges does not.

Plaintiff could amend his complaint to add particulars which would show that the bank's discriminatory waiver

of NSF charges violated some legal requirement. We are disturbed, however, that plaintiff has never advanced any theory under which the waiver would constitute unfair competition. Plaintiff has argued only that the waiver of NSF charges as to some customers shifts the processing costs to others. Even if true, that allegation would not suffice to prove unfair competition.

In conclusion, the superior court properly sustained a demurrer to plaintiff's fourth cause of action, but erred in denying leave to amend. Plaintiff should be permitted to amend to set out the alleged deceptive practices employed by defendant. The trial court would be within its discretion in denying leave to amend to claim unlawful discrimination in waiving NSF charges, but since plaintiff must be allowed to amend on the deceptive practices issue, the court may choose to permit amendment as to the waiver issue as well.

IV. *Plaintiff's fifth cause of action: whether the bank's charge for NSF checks is an unlawful penalty.*

Paragraph 42 of the complaint states that "[c]ausing NSF checks to be presented for payment is a breach by plaintiffs of their contractual obligations to defendant . . . ." The NSF charge collected by defendants, however, "is a penalty and is not imposed to compensate defendants for damages incurred by plaintiffs' breach", and therefore violates Civil Code sections 1670 and 1671. The complaint concludes that "[p]laintiffs are entitled to recover the difference between the unlawful charges collected and defendants' actual damages . . . ."

By these allegations, plaintiff seeks to invoke the rule that a contractual provision specifying damages for breach is valid only if it "represent[s] the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sus-

tained." (Better Food Mkts. v. Amer. Dist. Teleg. Co. (1953) 40 Cal.2d 179, 187; Garrett v. Coast & Southern Fed. Sav. & Loan Assn., *supra*, 9 Cal.3d 731, 739.) An amount disproportionate to the anticipated damages is termed a "penalty." A contractual provision imposing a "penalty" is ineffective, and the wronged party can collect only the actual damages sustained.[16]

Two Court of Appeal decisions have addressed plaintiff's contention and concluded that the writing of an NSF check is not a breach of contract, and thus the fee charged for processing the check is not a penalty.[17] In Hoffman v. Security Pacific Nat. Bank (1981) 121 Cal. App.3d 964, 968-969, the court said that "[p]laintiff argued, and attempted to prove, that the depositors entered into a covenant not to write NSF checks when they

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[16] In Garrett v. Coast Southern Fed. Sav. & Loan Assn., *supra*, 9 Cal.3d 731, the leading case, we considered a provision which imposed a charge for late payment of installments due under a trust deed, but computed that charge as a percentage of the unpaid principal balance. Defendant savings and loan association contended that the provision did not impose a penalty for breach of obligation, but offered borrowers an alternative method for performing their obligation.

We concluded, however, that "the only reasonable interpretation of the clause providing for imposition of an increased interest rate is that the parties agreed upon the rate which should govern the contract and then, realizing that the borrowers might fail to make timely payment, they further agreed that such borrowers were to pay an additional sum as damages for their breach which sum was determined by applying the increased rate to the entire unpaid principal balance. Inasmuch as this increased interest charge is assessed only upon default, it is invalid unless it meets the requirements of section 1671. [Citations.]" (P. 738.) We held that the liquidated damages provision was invalid because it calculated damages on the basis of the entire unpaid balance, not on the basis of the amount of the overdue installment or the cost to the defendant. (P. 740.)

[17] A New York decision, Jacobs v. Citibank, N.A., *supra*, —— N.Y. ——, —— reached the same conclusion.

executed signature cards . . . . Plaintiff attempted to show that industry custom prohibited the writing of overdrafts without prior agreement and that the depositors' promise to pay a service charge for any NSF check contained an implied covenant not to write such checks. [¶] Plaintiff failed to establish any such custom or any agreement on the depositors' part not to write overdrafts. Moreover, statutes governing the obligations of banks and their depositors, which are incorporated into and become part of the contract between a bank and its depositors [citations], treat an overdraft as an application for advance credit rather than as a breach of an express or implied covenant. California Uniform Commercial Code section 4401 specifically authorizes a bank to pay overdafts and to charge customers' accounts to recover amounts paid, even when payments result in overdrafts on the account. While a bank has a statutory obligation to honor any check drawn by a depositor for an amount not exceeding the balance in his account, and while the depositor has a contractual obligation to pay a service charge when he presents a NSF check, the depositor has no statutory or contractual obligation to refrain from drawing checks for amounts in excess of the balance in his account. (Cal. U. Com. Code, § 4401.)" (Pp. 968-969; accord, Shapiro v. United California Bank (1982) 133 Cal.App.3d 256, 262.)

We cannot entirely agree with *Hoffman* and *Shapiro* that the contract between the bank and the depositor treats an overdraft as an application for advance credit. The contract in fact is silent on the characterization of an NSF check, and the bank is aware that a depositor often writes overdrafts in the mistaken belief that he has, or will have, sufficient funds to cover the check, and without any intent to apply for credit.[18] We agree with

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[18] Contrary to the contention of the bank, such overdrafts are not necessarily the result of carelessness by the depositor; they may be the result of bank delay in crediting a deposit or of bank dis-

those decisions, however, that because the depositor has never agreed to refrain from writing NSF checks, the writing of such a check is not a breach of contract. The fee that the bank may charge for processing such a check is limited by principles of good faith, reasonableness, unconscionability, and the like, but it is not limited to the amount which a bank could recover in a suit for breach of contract. We conclude that the court correctly sustained the demurrer to plaintiff's fifth cause of action without leave to amend.

V. *Whether California law, as applied to NSF charges imposed by national banks, is preempted by federal law.*

Defendant contends that the provisions of California law on which plaintiff bases his causes of action are preempted by federal law. Since we have concluded that plaintiff's complaint states no cause of action for recovery of penalties under Civil Code section 1671, we do not discuss whether federal law preempts application of that section to banking charges. Instead, we focus our discussion on whether California law is preempted to the extent that it prohibits banks from exacting unreasonable charges (a doctrine applicable only when the contract does not expressly fix the charge) or enforcing unconscionable provisions (a doctrine applicable to all contracts).[19]

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honor of an NSF check submitted for deposit under a reasonable belief that the check was good.

[19] We note preliminarily that defendant appears to assume that if state law is preempted, federally chartered banks are free to enforce unconscionable contracts. We question that assumption; we believe that a federal court, deciding federal common law, might choose to follow the lead of the state courts and legislatures and limit the power of banks to enforce oppressive contracts. In particular, we suggest that the provisions of the Uniform Commercial Code, now in effect in 49 states, express a national consensus that courts should have the power to avoid unfair and

No provision of federal law discusses bank charges for NSF checks, or, for that matter, bank charges for any service performed for depositors. No federal statute considers whether provisions in contracts between banks and their customers may exact unreasonable or unconscionable fees. Defendant's preemption argument, consequently, is essentially an argument that even though the federal government has largely declined to regulate this area,[20] Congress has nevertheless decided to preclude state regulation.

Defendant cites various statutes and a newly promulgated administrative regulation as a basis for preemption. First, it refers to the National Bank Act of 1864, 13 Statutes at Large 99. Section 24 of this act (12 U.S.C. § 24) grants national banks general corporate powers upon proper filing of articles of association and an organizational certificate. Paragraph 7 empowers the board of directors or duly authorized officers or agents to exercise "all such incidental powers as shall be necessary to carry on the business of banking . . . by receiving deposits . . . ." Defendant asserts that the power to receive deposits necessarily includes the power to control related charges, and hence that such charges are exempt from state law. Amicus California Bankers Association also points to the statutory requirement that bank directors refrain from any "unsafe or unsound practice" (12 U.S.C. § 1818(e)), and argues that a

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oppressive contractual provisions. We need not decide questions of federal common law, however, because we have concluded that absent an evidentiary showing that the challenged state laws will impair the efficiency of national banks or their ability to perform their duties—which showing cannot be made by demurrer—federal law asserts no preemptive effect in this case.

[20] The Comptroller of the Currency could enjoin a bank service charge, or any other act of a national bank, which he considered an unsafe or unsound practice. (12 U.S.C. § 1818(b).) To our knowledge, this authority has never been used to curb excessive bank charges.

charge for NSF checks low enough to avoid an attack as unconscionable or penal might be inadequate to discourage the writing of such checks, and thus constitute an unsound practice.[21]

Next, defendant cites the Depository Institutes [sic] Deregulation and Monetary Control Act of 1980, 94 Statutes 132 (hereafter 1980 Act) and the Garn-St. Germain Depository Institutions Act of 1982, 96 Statutes at Large 1469 (hereafter 1982 Act). The 1980 and 1982 Acts aimed at the gradual removal of federal regulations limiting the interest banks could pay to depositors. The 1980 Act also preempted state usury laws to the extent that they limited the interest banks could collect on mortgages, but left intact state limits on other loan charges. Apart from that provision, neither act expressly preempts state law; neither discusses bank charges for NSF checks or other depositor services. Defendant nevertheless argues that Congress contemplated that after deregulation, banks would pay higher interest to depositors,

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[21] Defendant also cites 12 United States Code section 484, which provides that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law." Cases construing this section do not make clear when an unauthorized person or agency may, without violating this section, examine bank records for a limited purpose. (Compare Guthrie v. Harkness (1905) 199 U.S. 148, 157-159 [stockholder may inspect to determine the value of his stock] and Peoples Bank of Danville v. Williams (D.Va. 1978) 449 F.Supp. 254, 259-260 [Securities Exchange Commission may inspect to detect fraud in sale of bank stock] with National State Bank, Elizabeth N.J. v. Long (3d Cir. 1980) 630 F.2d 981, 989 [state commissioner may not inspect to enforce law against "redlining"].) Thus, it is possible that section 484 may serve to limit plaintiff's ability to examine records by way of discovery, or to subpoena such records at trial. Difficulties in proof, however, are irrelevant in ruling upon a demurrer. Since the bank can comply with California law without violating section 484, and plaintiff can state a cause of action for violation of such law without violating section 484, we find no present conflict between state law and section 484. Plaintiff will simply have to prove his case without using methods which violate that section.

and raise charges for services previously subsidized by the below-market interest rates on deposit accounts. Further, defendant claims Congress intended such charges to be set in a competitive market free of regulation.

Finally, defendant relies on a regulation promulgated by the Comptroller of the Currency just prior to argument in the present case.[22] The new regulation, effective December 2, 1983, amends 12 Code of Federal Regulations section 7.8000, which previously provided only that "[a]ll charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or even discussion among banks or their officers." As subsequently amended March 10, 1984, the new regulation adds subdivisions (b) and (c) to section 7.8000, to read as follows:

"(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision to be made by each bank according to sound banking judgment and federal standards of safety and soundness. In establishing deposit account service charges, the bank may consider, but is not limited to considering: [¶] (1) Costs incurred by the bank, plus a profit margin, in providing the service; [¶] (2) The deterrence of misuse by customers of banking services; [¶] (3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy; [¶] (4) Maintenance of the safety and soundness of the institution.

"(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the

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[22] Plaintiff charges that this regulation was promulgated to influence the decision of the court in the present case. We find no impropriety in an administrative agency issuing a regulation to clarify its position on contested issues in pending litigation.

amount of that charge. Such state laws are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks." [23]

The parties dispute whether the regulation is legislative or interpretative in character.[24] Plaintiff contends that it is legislative, and hence invalid because the Comptroller failed to comply with the notice and hearing re-

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[23] The regulation as promulgated on November 28, 1983, differed from the present version in two respects. First, subdivision (b), after stating that the setting of deposit account charges is a business decision made by each bank, added "and the Office will not substitute its judgment." According to the statement published in connection with the March 1984 amendment, this language was eliminated to avoid the implication that the Comptroller would not review bank service charges to determine whether they represented sound banking practice. (See 49 Fed. Reg. 28237 (July 11, 1934).) Second, former subdivision (c) asserted that state laws limiting banking service charges "impair the efficiency of national banks and conflict with the regulatory scheme governing the national banking system and are preempted by federal law." The present regulation asserts that such state laws "are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks." According to the Comptroller's statement, the language was changed to avoid any inference that the regulation itself, and not the statutes it purports to interpret, preempted state law. (*Ibid.*) We note, however, that the March amendment also changes the basis for preemption from the actual effect of state laws upon the federal program to the claim that the federal statutory scheme so occupies the field as to exclude state regulation.

[24] "Generally speaking, it seems to be established that 'regulations,' 'substantive rules' or 'legislative rules' are those which create law, usually implementary to an existing law; whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means." (Gibson Wine Co. v. Snyder (D.C.Cir. 1952) 194 F.2d 329, 331.) Interpretative "rules are essentially hortatory and instructional. . . . By merely clarifying the law's terms as applied situationally, interpretative or administrative-type rules are used more for discretionary fine-tuning than for general law making." (Alcarez v. Block (9th Cir. 1984) 746 F.2d 593, 613.)

quirements of the Administrative Procedure Act (5 U.S.C. § 553). Defendant maintains that it falls within the Administrative Procedure Act's exception for "interpretive rules" (5 U.S.C. § 553(b)(3)(A)).[25] As an interpretative regulation, section 7.8000 would be en-

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[25] "The APA's prescription of notice and comment procedures for agency rulemaking, 5 U.S.C. § 553, together with its broad definition of what amounts to a 'rule', U.S.C. § 551(4), reflect a commitment 'to reintroduce public participation and fairness to affected parties after governmental authority has been delegated to unrepresentative agencies.' Batterton v. Marshall, 648 F.2d 694, 703 (D.C.Cir. 1980) (footnote omitted). Among the limited exceptions to the general notice and comment requirement is the exemption for 'interpretive rules,' 5 U.S.C. § 553(b)(3)(A). This exemption, like the others, is to be narrowly construed. Humana of South Carolina, Inc. v. Califano, 590 F.2d 1070, 1082 (D.C.Cir. 1978)." (Credit Union National Association v. National Credit Union Administration Board (D.D.C. 1983) 573 F.Supp. 586, 591.)

Consequently, the Comptroller's decision to characterize his regulation as interpretative is not dispositive. (Columbia Broadcasting System, Inc. v. United States (1942) 316 U.S. 407, 416; Louisiana-Pacific Corp. v. Block (9th Cir. 1982) 694 F.2d 1205, 1210; Credit Union National Association v. National Credit Union Administration Board, *supra*, 573 F.Supp. 586, 591.) Courts inquire also into the function of the regulation in the administrative structure (see British Caledonian Airways, Ltd. v. C.A.B. (D.C.Cir. 1978) 584 F.2d 982, 994; Joseph v. United States Civil Service Commission (D.C.Cir. 1977) 554 F.2d 1140, 1153), and into its foreseeable effect (Louisiana-Pacific Corp. v. Block, *supra*, 694 F.2d 1205, 1210; Chamber of Commerce of United States v. O.S.H.A. (D.C.Cir. 1980) 636 F.2d 464, 469). It appears now to be generally agreed that proof that a regulation will have a "substantial impact" is not itself sufficient to require classifying that regulation as legislative in character, but that such impact is a proper factor for judicial consideration. (See Cabias v. Egger (D.C.Cir. 1982) 690 F.2d 234, 237.)

There is one exception to the foregoing principles: if the agency labels the regulation as legislative and promulgates it in accord with the requirements of the Administrative Procedure Act, then the regulation has the authority of a legislative rule even though it arguably constitutes only an interpretation of statutory law. (Cf. Levesque v. Block (1st Cir. 1983) 723 F.2d 175, 181-182.)

titled to consideration and weight, but would not be binding on the courts.[26]

We now turn to the question whether the foregoing statutes preempt application of California law in the case at bar. As the United States Supreme Court explained

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[26] Interpretative rules, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a [ruling] in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." (Skidmore v. Swift & Co. (1944) 323 U.S. 134, 140; General Electric Co. v. Gilbert (1976) 429 U.S. 125, 141-142.)

Other cases note that greater weight is given to an interpretation by an agency charged with the duty of administering the statute in question (Red Lion Broadcasting Co. v. FCC (1969) 395 U.S. 367, 381), particularly if the agency took part in the formulation of the statute (Miller v. Youakim (1979) 440 U.S. 125, 144), promulgated its interpretation contemporaneously with the enactment of the statute (see General Electric Co. v. Gilbert, *supra*, 429 U.S. 125, 142), or represents a consistent administrative construction of the act (*id.*). In the present case, these factors fall on both sides of the line. The Comptroller is charged with the execution of the relevant statutes. He took part in the drafting of the 1980 and 1982 Acts, and issued the regulation within a short time of the enactment of the later act. The regulation, on the other hand, is plainly not contemporaneous with the enactment of the National Bank Act. It does not represent a consistent administrative interpretation, since previous actions by the office of the Comptroller have not taken a consistent stand. (Defendant calls our attention to a letter from the Comptroller to the Chairman of the Legal and Monetary Affairs Subcommittee of the House of Representatives Committee on Governmental Affairs, dated Nov. 5, 1963, stating a preference for bank service charges set by free competition instead of local regulation. The letter does not purport to be interpreting existing statutes, or suggest that those statutes, without supplementary legislation, preempt state regulation. Plaintiff refers to an Aug. 27, 1977, letter from the Legal Advisory Services Division of the Comptroller's office stating that state limitations on service charges are not preempted.)

in Silkwood v. Kerr-McGee Corp. (1984) —— U.S. —— [52 U.S. L. Week 4043], "state law can be preempted in either of two general ways. If Congress evidences an intent to occupy a given field, any state law falling within that field is preempted. [Citations.] If Congress has not entirely displaced state regulation over the matter in question, state law is still preempted to the extent it actually conflicts with federal law, that is, when it is impossible to comply with both state and federal law [citation], or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress . . ." (—— U.S. at p. —— [52 U.S. L. Week at p. 4046]; accord, Pac. Gas & Electric v. St. Energy Resources Conserv. (1984) —— U.S. ——, —— [103 S.Ct. 1713, 1722].) Defendant bears the burden of persuasion on this issue; "[c]ourts are reluctant to infer preemption, and it is the burden of the party claiming Congress intended to preempt state law to prove it." (Elsworth v. Beech Aircraft Corp. (1984) 37 Cal.3d 540, 548 and cases there cited.)

Defendant contends that Congress, by comprehensive regulation, has occupied the field of regulation of contracts between national banks and their depositors. One hundred and fifteen years of practice under the national banking system argue to the contrary. While nationally chartered banks are subject to the paramount authority of the United States,[27] Congress has declined to provide an entire system of federal law to govern every aspect

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[27] Davis v. Elmira Savings Bank (1896) 161 U.S. 275, 283. Under our dual banking system, commercial banks have the option of being federally or state chartered. Federally chartered (national) banks are governed by the National Bank Act of 1874 [sic] (12 U.S.C. § 21 et seq.) which sets forth chartering criteria, basic banking and investment powers, lending and borrowing limitations, and corporate powers and duties. As required members of the Federal Reserve System and insured of the Federal Deposit Insurance Corporation (FDIC), national banks are also subject to the Federal Reserve Act (12 U.S.C. §§ 221-530), and the FDIC Act (12 U.S.C. § 1811 et seq.).

of national bank operations. Consequently, national banks have traditionally been "governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws." (National Bank v. Commonwealth (1869) 76 U.S. (9 Wall) 353, 362; see Scott, *The Dual Banking System: A Model of Competition in Regulation* (1977) 30 Stan. L. Rev. 1.)[28] As explained in National State Bank, Elizabeth, N.J. v. Long (3d Cir. 1980) 630 F.2d 981, "[w]hatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the first National Bank Act in 1863. . . . In only a few instances has Congress explicitly preempted state regulation of national banks. More commonly, it has been left to the courts to delineate the proper boundaries of federal and state supervision. [¶] The judicial test has been a tolerant one. [National banks'] right to contract, collect debts, and acquire and transfer property are all based on state law." (P. 985.) Thus the rule is that state laws apply, "the exception being the cessation of the operation of such laws whenever they expressly [29] conflict with the laws of the United States or frustrate the purpose for which national banks were created, or impair their efficiency to discharge [their] duties . . . ." (McClellan v. Chipman (1896) 164 U.S. 347, 357.)[30]

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[28] Courts have routinely applied state contract law in cases involving national banks. See, e.g., Wichita Eagle & Beacon Publishing Co. Inc. v. Pacific Nat'l Bank (9th Cir. 1974) 493 F.2d 1285; Fowler v. Security First National Bank (1956) 146 Cal.App. 2d 37; Security First National Bank v. Rospaw (1951) 107 Cal. App.2d 220.

[29] The Supreme Court has at times preempted state law on the basis of an implied, rather than an express, conflict. (Compare, Franklin Nat'l Bank v. New York (1954) 347 U.S. 373 with Davis v. Elmira Savings Bank, *supra*, 161 U.S. 275.)

[30] This rule has been consistently followed over the years. Lewis v. Fidelity & Deposit Co. (1934) 292 U.S. 559, 566; First Nat'l

The assertion in the regulation that state laws limiting bank service charges "are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks" (12 C.F.R. § 7.8000, subd. (c)) is palpably erroneous. There is no comprehensive federal statutory scheme governing the taking of deposits. There is one relevant statute, section 24 of the National Bank Act, and that merely authorizes banks to accept deposits. Section 24 may by implication also authorize banks to charge for deposit-related services as an incidental power necessary to carry on the business of receiving deposits, but such implied authority does not constitute a regulatory scheme so comprehensive as to displace state law.[31]

Under the Comptroller's interpretation, any banking matter related to deposits would be exempt from state law. The result would be far-reaching and extremely disruptive. Currently, California and most other states extensively regulate all banks within their territory. For example, article 4 of the Uniform Commercial Code (codified at Cal. U. Com. Code, §§ 4101-4407), entitled

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Bank v. Missouri (1923) 263 U.S. 640; Nat'l. State Bank v. Long (3d Cir. 1980) 630 F.2d 981, 985-986; Brown v. United Community Nat'l Bank (D.D.C. 1968) 282 F.Supp. 781, 783; South Dakota v. Nat'l Bank (D.S.D. 1963) 219 F.Supp. 842, 844-845, affirmed (8th Cir. 1964) 335 F.2d 444, certiorari denied (1965) 379 U.S. 970. The test has sometimes been phrased more loosely; see, e.g., Anderson Nat'l Bank v. Luckett (1944) 321 U.S. 233, 248 ("national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions").

[31] Cf. Joy v. North (D.Conn. 1981) 519 F.Supp. 1312, 1323, reversed on other grounds (2d Cir. 1982) 692 F.2d 880, certiorari denied, Citytrust v. Joy (1983) 103 S.Ct. 1498. *Joy* rejected the argument that section 24's granting of general corporate powers preempts state corporation law: "This section [12 U.S.C. § 24] simply sets forth the general corporate powers of associations. It does not provide that the powers therein are meant to preempt state law."

"Bank Deposits and Collections" has been adopted in 49 states and is routinely applied to national banks.[32] Also, numerous provisions of the California Financial Code regulate deposit-related practices.[33] Financial Code section 100 specifically subjects national banks to its provisions insofar as those provisions do not conflict with federal law. The Comptroller's interpretation would suddenly exempt national banks from many, if not all, of these regulatory measures. There is nothing to suggest that Congress, by authorizing national banks to receive deposits, intended such a result.

The United States Supreme Court decisions construing section 24 do not support the Comptroller's expansive interpretation. Instead, whether upholding or preempting the state law, the court has focused on the narrow issue of whether the state law impeded the bank's ability to receive deposits. For example, Franklin Nat'l Bank v. New York (1954) 347 U.S. 373 held that a New York statute which prohibited all banks except nonprofit state chartered banks from using the term "savings" in their advertising, conflicted with the national bank's authorization to receive deposits.[34] Emphasizing the importance

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[32] See, e.g., Bullis v. Security Pacific Nat'l Bank, *supra*, 21 Cal.3d 801 (§ 4103); Security Pacific National Bank v. Associated Motor Sales (1980) 106 Cal.App.3d 171 (§ 4301, 4212); Fireman's Fund Insurance Co. v. Security Pacific Nat'l Bank (1978) 85 Cal.App.3d 797 (§§ 4202, 4207, 4401); Bank of America v. Security Pacific Nat. Bank (1972) 23 Cal.App.3d 638 (§ 4308).

[33] For example, chapters 7 and 8 of the Financial Code contain the following provisions affecting deposits: Section 850 (minors), section 851 (married person), section 852 (joint accounts), section 852.5 (pay-on-death provisions), section 860 (public official as officer of depository of public funds), section 863 (penalties for failure to deposit), sections 865.2 and 865.4 (disclosure of consumer bank account charges), section 874 (dormant accounts), sections 953, 954, 970, 971 (withdrawals and collections).

[34] In addition to section 24 of the National Bank Act, the court also relied on the Federal Reserve Act which provides that a na-

of advertising in competing for deposits, the court reasoned that the statute interfered with the bank's ability to receive deposits. "[W]e [cannot] construe the [National Bank Act and the Federal Reserve Act] as permitting only a passive acceptance of deposits thrust upon them. Modern competition for business finds advertising one of the most usual and useful of weapons." (*Id.*, at p. 377.)

Similarly, in another case the court found that a California law which automatically escheated dormant accounts to the state was preempted by section 24 because it impeded the bank's ability to attract deposits. (First National Bank v. California (1923) 262 U.S. 366.) But as the court later explained in Anderson Nat'l Bank v. Luckett, *supra*, 321 U.S. 233, 250, not all state escheat laws are preempted: "[The] decision [in *First Nat'l*] turned . . . on the effect of the state statute in altering the contracts of deposit in a manner considered so unusual and so harsh in its application to depositors as to deter them from placing or keeping their funds in national banks." [35] Nowhere did the court suggest that section 24 preempts all state regulation of deposit-related matters.

In an attempt to bring itself within these cases, defendant argues that *Franklin* in particular implies that

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tional bank "may continue . . . to receive time and savings deposits . . . ." (12 U.S.C. § 371.)

The purpose of the New York statute was to prevent consumer confusion between commercial banks and the state chartered institutions which pay larger returns on deposits.

[35] In *Anderson*, the court found a Kentucky law requiring transfer of abandoned, as opposed to merely dormant, accounts to the state was not preempted by section 24. "We cannot say that the protective custody of long inactive bank accounts, for which the Kentucky statute provides, and which in many circumstances may operate for the benefit and security of depositors . . . will deter them from placing their funds in national banks in that state." (*Id.*, at p. 252.)

all terms and conditions upon which national banks may compete for deposits are presumed to be the exclusive province of federal law. This reading of *Franklin* is unduly broad. *Franklin* preempted the New York law because of its deterrent effect on deposits. This holding does not logically extend into the broader proposition that every possible term or practice which may be the subject of competition between banks is beyond the reach of state law. As the numerous regulations cited earlier demonstrate, it is possible for states to regulate such "terms or conditions" without impeding banks' ability to attract deposits. And in the present setting, it is difficult to believe that persons would be deterred from depositing in federally chartered banks by the knowledge that such banks, like their state chartered counterparts, were prohibited by state law from enforcing unreasonable charges or unconscionable contracts.[36]

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[36] The bank's reliance on Fidelity Federal Savings & Loan Ass'n v. de la Cuesta (1982) 458 U.S. 141 is also misplaced. As defendant concedes, the court in that case identified an express conflict between our decision in Wellenkamp v. Bank of America (1978) 21 Cal.3d 943, which invalidated "due-on-sale" clauses as unreasonable restraints on alienation, and a Federal Home Loan Bank Board *legislative* regulation which provided that federal savings and loans have the power to include and enforce "due-on-sale" clauses in their loan instruments. (12 C.F.R. § 545.8-3(f) (1982).) Relying largely on the regulation's preamble, which stated that "due-on-sale" practices should be governed by federal law and not subject to conflicting state law, the court found the board's intent to preempt *Wellenkamp* was unambiguous and unequivocal. Thus the court's holding was clearly based upon a finding of an express conflict and an unambiguous intent to preempt state law, neither of which is present here.

Nevertheless, defendant makes the unfounded assertion that the court also held that state law is preempted, even in the absence of a direct conflict, on the strength of the federal interest in the financial well-being of federally chartered banking institutions. The court expressly noted that because it found a direct conflict, it did not reach the issue of whether Congress has occupied the entire field of federally chartered savings and loans, much less national banks.

If the National Bank Act does not displace state regulation of bank service charges, the additional enactment of the 1980 and 1982 Acts adds nothing. As we have seen, these statutes do not mention bank service charges; neither separately nor in combination with the National Bank Act can they be described as a comprehensive scheme regulating such charges. Moreover, when in the 1980 Act Congress expressly preempted state usury laws, it deliberately left in effect other provisions of state law regulating charges in contracts between banks and borrowers.[37] It is not plausible that the same Congress intended by silence to preempt all state laws regulating charges in contracts between banks and depositors.

We conclude that the Comptroller's assertion that state laws regulating service charges are preempted by a "comprehensive federal statutory scheme governing the deposit-taking function of national banks" (12 C.F.R. § 7.8000) is not a reasonable interpretation of the controlling statutes. It is not an attempt to interpret the language of the statute,[38] fill in the gaps in the statutory

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[37] The Senate committee report on the 1980 Act states that "[i]n exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers." (Sen. Rep. No. 96-368, 1st Sess., p. 19 (1979).) Thus the committee intended to leave many features of the contract between a bank and a borrower to be governed by state law, including state provisions which placed a limit on the amount the bank could charge.

[38] In determining whether a regulation represents a reasonable interpretation, the courts look initially to the plain meaning of the statutory language. (See, e.g., Addison v. Holly Hill Co. (1944) 322 U.S. 607, 617-618; Cabais v. Egger (D.C.Cir. 1982) 690 F.2d 234, 238.) In State of N.J. v. Department of Health & Human Services (3d Cir. 1981) 670 F.2d 1262 at page 1283, footnote 17, when the court upheld a regulation as a reasonable statutory inter-

coverage,[39] or to explain how the Comptroller will exercise his discretion.[40] Instead, the regulation, insofar as it claims federal preemption, represents legislation of far-reaching character and effect, of a type never considered by Congress, which would radically alter the respective roles of the states and the Comptroller in the regulation of bank-depositor contracts. Such legislation cannot be enacted in the guise of statutory interpretation.[41]

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pretation, it distinguished an earlier case, Reser v. Califano (W.D. Mo. 1979) 467 F.Supp. 446, on the ground that " '[t]he Agency in *Reser* did not purport to derive the prohibition . . . from any specific language in the Act.' "

[39] Compare Ford Motor Credit Co. v. Milhollin (1980) 444 U.S. 555, 566, upholding intersticial administrative regulations; 2 Davis, Administrative Law Treatise (2d ed. 1979) session [sic] 7.11. The decision of the Court of Appeal in Chamber of Commerce of the United States v. O.S.H.A., *supra*, 636 F.2d 464, illustrates the limits on the use of interpretative rules to fill in legislative gaps. Holding invalid a rule requiring "walkaround pay," the court said that "[t]he Administration could not be explaining or clarifying the Act's language, for . . . the Act neither prohibits nor compels pay for walkaround time. . . . Congress has not 'legislated and indicated its will' on the question of walkaround pay, therefore the Administration must have done more than exercise its 'power to fill up the details.' [¶] It is clear to us that the Administration has attempted through this regulation to supplement the Act, not simply to construe it, and therefore the regulation must be treated as a legislative rule." (P. 469.)

[40] Compare Guardian Federal S & L v. Federal S & L Ins. Corp. (D.C.Cir. 1978) 589 F.2d 658, 664; 2 Davis, *op. cit. supra*, section 7.15.

[41] During the 1960's the Comptroller issued a number of interpretative regulations which purported to interpret the provision of section 24 of the National Bank Act authorizing banks to conduct activities "convenient or useful" to the business of banking, to permit banks to engage in data processing, auto leasing, travel agent services and armored car services. The courts consistently held such regulations invalid. (See Arnold Tours, Inc. v. Camp (1st Cir. 1972) 472 F.2d 427, and cases cited p. 436, fn. 12.) We

Thus the application of state law to bank service charges is not preempted by a comprehensive federal statutory scheme which occupies the field. We therefore turn to the second preemption issue, whether the application of state law in this case will create an actual conflict with federal law in the sense that "it is impossible to comply with both state and federal law." (Silkwood v. Kerr-McGee Corp., *supra*, —— U.S. ——, —— [52 U.S. L. Week 4043, 4046].) As we have noted, no provision of federal law discusses bank service charges in general or bank charges for NSF checks in particular. Amicus California Bankers Association nevertheless points to a possibility of actual conflict. Bank directors, it observes, are required to refrain from engaging "in any unsafe or unsound practice." (12 U.S.C. § 1818 (e).) Conceivably directors might believe a charge for NSF checks low enough to avoid attack as unreasonable or unconscionable might fail to discourage the writing of NSF checks, and thus constitute an unsafe or unsound practice.

Amicus' argument proves too much, for if the mere possibility that bank directors might deem compliance with a state law to be unsound banking practice was enough to preempt the state law, the dual system of banking regulation would disappear. We recognize, of course, that in the unlikely event of actual conflict, banks must follow the federal requirements. But such actual conflict is a remote and unlikely possibility; a contractual term must be overreaching and oppressive before it is denominated "unreasonable" or "unconscionable." Surely sound banking practices would rarely, if ever, require the enforcement of oppressive contracts.[42]

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find an analogy to the present case, in which the Comptroller is also seeking to construe very general language in section 24 to achieve a specific purpose not within the contemplation of Congress.

[42] Under the Comptroller's regulation, in setting fees for services [sic] bank may consider (1) costs plus a profit margin, (2) the deterrence of misuse of banking services, (3) the enhancement of the

Finally, we come to the question whether the application of state law will stand as an obstacle to the accomplishment of the full purposes Congress sought to achieve. Defendant's argument on this matter centers on the 1980 and 1982 Acts discussed earlier in this opinion. (*Ante*, p. ——.)* As we there noted, these acts provided for gradual removal of federal regulations limiting interest paid depositors, but, apart from preempting state usury laws, did not expressly discuss the role of state regulation. Neither act mentions charges for services to depositors.

The extensive legislative history of the acts shows that Congress expected deregulation to lead banks to pay higher interest to depositors, ending the bank's ability to subsidize depositor services by paying below-market interest on deposits. Thus, Congress clearly anticipated that banks would be able to charge fees for depositor services sufficient to recover the cost of such services. Arguably a state law which required that services be offered free, or below cost, would frustrate the congressional intent by preventing the bank from paying market interest to depositors.

The state laws in question, however, permit the bank to charge fees sufficient to recover the cost of the services and a reasonable profit. We find nothing in the legislative history to suggest that Congress thought it essential that the banks be able to charge more. While an excessive charge for depositor services might help the economic status of a bank, and could enable it to subsidize interest payments and pay above-market interest, we find no indication that such is essential to the congressional purpose.

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bank's competitive position, and (4) maintenance of the safety and soundness of the bank. These same factors could be considered by a court in deciding whether a fee was unreasonable or unconscionable.

* Typed opinion at page 29.

Defendant also argues that underlying both the 1980 and 1982 Acts is the philosophy that service charges as well as interest rates should be set by market forces, not government regulations.[43] Defendant's argument mistakes the purpose of the provisions of state law at issue here. Those provisions are part of the common law governing all commercial transactions; they regulate not only sale of bank services but the sale of groceries, automobiles, furniture or medical services. The duty of good faith and fair dealing, and protection against unconscionable contracts, have never been thought incompatible with a free and competitive market. Defendant is really asking for a market free of those restraints against oppression and overreaching applicable to all other commercial operations. We find no indication that Congress envisioned not only a free and competitive market, but one freer than any other market.

In sum, the controlling doctrines of California law do not facially conflict with any federal statute or regulation. Neither does it appear from the pleading that the application of these doctrines to national bank contracts will impair the efficiency or viability of national banks, or frustrate the purpose of legislation regulating (or deregulating) those banks. Although conceivably information not contained in the pleadings might lead to a different conclusion, such information is not before us in reviewing a judgment upon demurrer. We cannot presume, without evidence, that prohibiting a national bank from setting unreasonable prices or enforcing an unconscionable contract will render that bank

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[43] Defendant consistently assumes throughout its argument that because its charges for processing NSF charges are within the range of fees charged by its competitors, its fees are the product of a free and competitive market. The conclusion does not follow from the premise. It may well be, as plaintiff charges, that banks do not compete in the setting of NSF check fees, but set fees arbitrarily, deterred only by the desirability of minimizing customer dissatisfaction.

less efficient, less competitive or less able to fulfill its function in a national banking system.[44]

VI. *Conclusion.*

Plaintiff's second and third causes of action state grounds for relief without need for further amendment; his first and fourth causes of action can be amended to state such grounds. The fifth cause of action alone is fatally defective. We conclude that the trial court erred in sustaining defendant's demurrer without leave to amend and in entering judgment for defendant.

The judgment is reversed, and the cause remanded to the superior court for further proceedings consistent with this opinion.

BROUSSARD, J.

WE CONCUR:

BIRD, C.J.
MOSK, J.
REYNOSO, J.
* WHITE, J.P.T.
* BREINER, J.P.T.
* SAVITT, J.P.T.

[Designation of counsel and trial court and appended signature card exemplar omitted]

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[44] Plaintiff's fourth cause of action charged the bank with unfair and deceptive practices. We have concluded that this cause of action is uncertain, and until the uncertainty is clarified, and the alleged unfair or deceptive practices specified, we cannot determine whether that cause of action is barred by federal law. We note, however, that although many federal statutes and regulations deal with the subject of unfair competition and deceptive practices, such statutes and regulations generally coexist peacefully with state laws regulating the same activity. (Cf. People v. Western Airlines (1984) 155 Cal.App.3d 597, cert. den. sub. nom. California v. Western Airlines (1985) —— U.S. ——.)

* Assigned by the Chairperson of the Judicial Council.

APPENDIX B

[Designation of counsel and certificate of service omitted]

SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 740-352

PAUL PERDUE, on behalf of himself and all other persons similarly situated,
Plaintiffs,

v.

CROCKER NATIONAL BANK, and DOE ONE through DOE ONE HUNDRED, inclusive,
Defendants.

[Filed February 16, 1979]

JUDGMENT OF DISMISSAL

Defendant Crocker National Bank's general demurrer to plaintiff's Complaint was considered by the Court on the briefs of the parties and without oral argument. Gary J. Near appeared as attorney for plaintiff Paul R. Perdue. Melvin F. Goldman, Charles R. Farrar, Jr., and Tony J. Tanke of Morrison & Foerster, appeared as attorneys for defendant Crocker National Bank (hereinafter "Crocker"). This Court has entered its Order sustaining without leave to amend Crocker's general demurrers to the Complaint, and each purported cause of action therein, for failure to state facts sufficient to constitute a cause of action.

Whereupon:

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED AS FOLLOWS:

1. That the Complaint, and each purported cause of action therein, are dismissed with prejudice for failure to state facts sufficient to constitute a cause of action;

2. That plaintiff is entitled to no relief in connection with any controversy alleged in the Complaint;

3. That each of plaintiff's prayers for relief is denied; and that plaintiff shall take nothing by his Complaint;

4. That Crocker shall recover from plaintiff its costs of suit.

Dated: February 15, 1979

/s/ Ira A. Brown, Jr.
IRA A. BROWN, JR.
Judge of the Superior Court

APPROVED AS TO FORM:

/s/ Gary J. Near
GARY J. NEAR
Attorney for plaintiff
Paul Perdue

APPENDIX C

[Emended to reflect April 22, 1983
order on rehearing]

IN THE COURT OF APPEAL OF THE
STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT
DIVISION ONE

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1 Civil No. 46808
(AO 13838)
(S.Ct.No. 740351)

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

[Filed March 25, 1983]

Appellant Paul Perdue, a depositor with respondent Crocker National Bank (Crocker), filed a purported class action below challenging the validity of charges assessed by Crocker against its depositors for processing checks drawn on commercial checking accounts without sufficient funds. Thereafter, Crocker's general demurrer

was sustained without leave to amend and a judgment of dismissal entered. This appeal ensued.

We examine the complaint before us under established principles governing review of a judgment of dismissal based upon a claimed failure to state a valid cause of action. (E.g., *Tameny v. Atlantic Richfield Co.* (1980) 27 Cal.3d 167, 170; *Alcorn v. Anbro Engineering, Inc.* (1970) 2 Cal.3d 493, 496.)

The complaint asserts five causes of action alleging in substance that Crocker's customary practice in dealing with a check drawn by a depositor on an account lacking sufficient funds ("NSF check") is either to honor and pay it as an overdraft or to dishonor and return it to the payee's banks; that in either event Crocker assesses a special handling charge ("NSF charge") against the account of its depositor-maker. It is further alleged that appellant has periodically drawn NSF checks on his Crocker checking account which Crocker—in either honoring or dishonoring such checks—has assessed a special handling charge of $6 for processing each NSF check.

I.

The gravamen of the first three causes of action for declaratory relief and unjust enrichment is that Crocker lacked any contractual or statutory authority to impose charges for NSF checks. The first cause of action seeks a declaration that the signature card signed by appellant upon opening his account, which contains an agreement that the account shall be "*subject* to all applicable laws, *to the Bank's present and future* rules, regulations, practices and *charges*" does not constitute a valid contract to serve as a basis for imposing NSF charges. (Emphasis added.) In the second cause of action, appellant seeks a declaration that the signature card constitutes an unenforceable contract of adhesion. In the third cause of action for unjust enrichment, damages are sought by

way of a refund of the difference between the charges assessed and Crocker's actual cost in processing the NSF charges.

We will conclude that neither theory survives critical analysis. [Appellant concedes the third cause of action is viable only if one of the first two causes of action is valid.]

We consider the validity of the several causes of action in a sequence convenient for discussion.

I.

The courts have long recognized that a bank signature card serves as a contract between the depositor and the bank for the handling of the account. (See *Bullis v. Security Pac. Nat. Bank* (1978) 21 Cal.3d 801, 811-812; *Blackmon v. Hale* (1970) 1 Cal.3d 548, 556; *Manti v. Gunari* (1970) 5 Cal.App.3d 442, 450-451; *Torrance N. Bk. v. Enesco F. Credit Union* (1955) 134 Cal.App.2d 316, 320-321; *Larrus v. First National Bank* (1954) 122 Cal.App.2d 884, 889-890; *Faulkner v. Bank of Italy* (1924) 69 Cal.App. 370, 374-375.) The fact that the signature card itself does not indicate the amount of Crocker's NSF charges does not negate the contractual nature of such charges, particularly where, as here, the bank's rules and regulations specifying the charges are incorporated into the signature card agreement. (*State v. San Francisco Sav. etc. Soc.* (1924) 66 Cal.App. 53, 61; *Larrus v. First Nat. Bank, supra*, 122 Cal.App.2d at pp. 889-890.) Moreover, since appellant acknowledges he had notice of the bank's scheduled charges for processing NSF checks ($6 per check), the argument advanced is patently untenable. Under the terms of the subsisting agreement, Crocker has express contractual authority to assess its scheduled service charges whenever its depositor, including appellant, presents an NSF check.

A similar contention was raised and implicitly rejected in *Hoffman v. Security Pacific Nat. Bank* (1981) 121

Cal.App.3d 964, involving a depositor's claim that the bank's imposition of service charges for processing an NSF check constituted unlawful liquidated charges on the theory that the agreement contained in the signature card to pay scheduled service charges amounted to an implied covenant by the depositor not to write overdrafts. In upholding a judgment of nonsuit, the court reasoned as follows: "Plaintiff failed to establish any such custom or any agreement on the depositors' part not to write overdrafts. Moreover, statutes governing the obligations of banks and their depositors, which are incorporated into and become part of the contract between a bank and its depositors [citations], treat an overdraft as an application for advance credit rather than as a breach of an express or implied covenant. California Uniform Commercial Code section 4401 specifically authorizes a bank to pay overdrafts and to charge customers' accounts to recover amounts paid, even when payments result in overdrafts on the account. While a bank has a statutory obligation to honor any check drawn by a depositor for an amount not exceeding the balance in his account, and *while the depositor has a contractual obligation to pay a service charge when he presents a NSF check*, the depositor has no statutory or contractual obligation to refrain from drawing checks for amounts in excess of the balance in his account. (Cal. U. Com. Code, § 4401.) In brief, plaintiff did not and could not prove that the depositors breached an obligation to Bank when they negotiated NSF checks. Accordingly, *the service charge they agreed in advance to pay for presenting such an overdraft* was not a penalty under former Civil Code section 1670." (*Id.*, p. 969; emphasis added.) (Accord *Shapiro v. United California Bank* (1982) 133 Cal.App.3d 256.)

Nor do we find merit in appellant's further argument that the signature card is an illusory contract because it permits the bank unilaterally to fix the NSF charges

and to make future changes at will. It is well established that an agreement which reserves the power to one party to vary a term is not thereby rendered illusory or otherwise void for lack of mutuality. (See *Vanguard Investments v. Central Cal. Fed. Sav. & Loan Assn.* (1977) 68 Cal.App.3d 950, 958; *Powell v. Central Cal. Fed. Sav. & Loan Assn.* (1976) 59 Cal.App.3d 540, 549 [loan agreement permitting lender to increase rate of interest]; *Automatic Vending Co. v. Wisdom* (1960) 182 Cal.App.2d 354, 358 [agreement permitting vendor to change commission rate]; *Inderkum v. German Old People's Home* (1937) 23 Cal. App.2d 733, 735 [life care contract subject to future amendments of by-laws].) However, the exercise of the power to effect changes must be reasonable. Thus, for example, in *Inderkum* the court held that the future by-law amendments must be "reasonable administrative amendments" and not changes impairing the substance of the contract. (23 Cal.App.2d at p. 738.) In *Automatic Vending*, the court held the new price must be fixed "in such amount as the object of the contract is reasonably worth." (182 Cal.App.2d at p. 358.) And in *Powell v. Central Cal. Fed. Sav. & Loan Assn.*, *supra*, the court found the lender's one percent increase in the interest rate was reasonable when compared with the interest increases for depositors. (59 Cal.App.3d at pp. 549-550.)[1]

Appellant advances an alternative argument that the signature card constitutes an unenforceable contract of adhesion because depositors receive inadequate notice that execution of the signature card subjects them to NSF charges and by reason of the great disparity between the NSF charge and the bank's actual cost of

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[1] We emphasize that no question is raised in this case regarding Crocker's exercise of its power to *change* the NSF charges. Accordingly, we express no opinion as to the permissible latitude in increasing such charges unilaterally.

processing NSF checks. We disagree on the record before us.

Conceptually, a contract of adhesion generally "'. . . signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" (*Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817; *Neal v. State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694.) Although arguably the signature card may reasonably be interpreted as a contract of adhesion between the bank and its depositor, such determination does not end the inquiry. "There is nothing sinful or illegal about a contract of adhesion; the only significant result of the existence of such a contract is that it is interpreted against the supplier of the goods or services (who prepared it) so as to meet the reasonable expectations of the customer." (*Powell v. Central Cal. Fed. Sav. & Loan Assn., supra*, 59 Cal.App.3d 540, 551.)

As *Scissor-Tail* instructs, the provisions of an adhesion contract are fully enforceable in the absence of two judicially imposed constraints: "The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. (See, e.g., *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 271-272 [54 Cal.Rptr. 104, 419 P.2d 168]; *Steven v. Fidelity & Casualty Co.* (1962) 58 Cal.2d 862, 869-870 [27 Cal. Rptr. 172, 377 P.2d 284]; *Wheeler v. St. Joseph Hospital, supra*, 63 Cal.App.3d 345, 357; see generally *Sybert, supra*, at pp. 305-306, and cases there cited.) The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.' (See, e.g., *Steven, supra*, 58 Cal.2d at pp. 878-879; *Jacklich v. Baer*

(1943) 57 Cal.App.2d 684 [135 P.2d 179].)" (Fns. omitted.) (*Graham v. Scissor-Tail, Inc., supra*, 28 Cal. 3d at p. 820; see also *Holmes v. City of Los Angeles* (1981) 117 Cal.App.3d 212, 216-217, app. dis. 454 U.S. 884.) Although in *Scissor-Tail* the court determined that the contract between a sophisticated promoter and a music performer was a contract of adhesion, the court further concluded that the contractual provision requiring arbitration of disputes was in nowise contrary to the promoter's expectations, particularly since he had been a party to literally thousands of contracts containing similar arbitration provisions and was undoubtedly aware of the arbitration requirement. (*Graham v. Scissor-Tail, Inc., supra*, at p. 821.)

In congruent analysis, we find nothing ambiguous or unexpected about the specific NSF charges imposed by Crocker. The signature card agreement plainly states that the depositor will pay the bank's scheduled processing charges. As noted, appellant acknowledges he was aware of the NSF charges before he wrote the NSF checks. Under such uncontroverted circumstances, we conclude that the signature card in no way conflicts with appellant's reasonable expectations.

Appellant's next argument, to which the parties and amici devote considerable discussion in their briefs, focuses on the second factor underscored in *Scissor-Tail* limiting enforcement of adhesion contracts: namely, whether the contract or provision is unduly oppressive or unconscionable. Appellant contends that the disparity between the bank's actual *costs* of processing NSF checks (alleged to be 30¢ per check) and the *charges* imposed ($6 per check) is so excessive as to render the contract unconscionable and unenforceable. Again we are unable to agree.

In the recent decision of *A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, the appellate court

thoroughly examined the flexible concept of unconscionability in the context of the enforceability of a warranty disclaimer and damages exclusion clause contained in a commercial contract. We can add little to that enlightening exegisis by Justice Wiener which we adopt in pertinent part herein: "Phrased another way, unconscionability has both a 'procedural' and a 'substantive' element. (*Industralease Automated & Scientific Eq. Corp., etc.* (1977) 58 App.Div.2d 482 [396 N.Y.S.2d 427, 431, fn. 4]; see also Leff, *supra*, 115 U.Pa.L.Rev. at p. 487; White and Summers, *supra*, § 4-3 at p. 151.)

"The procedural element focuses on two factors: 'oppression' and 'surprise.' (See U. Com. Code com. No. 1, 23A West's Ann. Cal. U. Com. Code (1964 ed.) § 2302, p. 198; *Geldermann and Company, Inc. v. Lane Processing, Inc.* (8th Cir. 1975) 527 F.2d 571, 575.) 'Oppression' arises from an inequality of bargaining power which results in no real negotiation and 'an absence of meaningful choice.' (*Williams v. Walker-Thomas Furniture Company*, supra, 350 F.2d at p. 449; *Fleischmann Distilling Corp. v. Distillers Co. Ltd.* (S.D.N.Y. 1975) 395 F.Supp. 221, 232; see Spanogle, *Analyzing Unconscionability Problems* (1969) 117 U.Pa.L.Rev. 931, 944-946.) 'Surprise' involves the extent to which the supposedly agreed-upon terms of the bargain are hidden in a prolix printed form drafted by the party seeking to enforce the disputed terms. (See Ellinghaus, *In Defense of Unconscionability* (1969) 78 Yale L.J. 757, 764-765; Eddy, *On the 'Essential' Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)* (1977) 65 Cal.L.Rev. 28, 43; Spanogle, *supra*, 117 U.Pa. L.Rev. at pp. 934-935, 943.) Characteristically, the form contract is drafted by the party with the superior bargaining position. (See Calamari and Perillo, Contracts (2d ed. 1977) § 9-40, p. 325.)

"Of course the mere fact that a contract term is not read or understood by the nondrafting party or that the

drafting party occupies a superior bargaining position will not authorize a court to refuse to enforce the contract . . . [since] commercial practicalities dictate that unbargained-for terms only be denied enforcement where they are also *substantively* unreasonable. (Ellinghaus, *supra*, 78 Yale L.J. at pp. 766-767; Murray on Contracts, *supra*, at pp. 748-749.) No precise definition of substantive unconscionability can be proffered. Cases have talked in terms of 'overlyharsh' or 'one-sided' results. (See, e.g., *Schroeder v. Fageol Motors, Inc.* (1975) 86 Wn.2d 256 [544 P.2d 20, 23]; *Weaver v. American Oil Company* (1972) 257 Ind. 458 [276 N.E.2d 144, 146, 49 A.L.R.3d 306].) One commentator has pointed out, however, that '. . . unconscionability turns not only on a "one-sided" result, but also on an absence of "justification" for it' (Eddy, *supra*, 65 Cal.L.Rev. at p. 45), which is only to say that substantive unconscionability must be evaluated as of the time the contract was made. (See U. Com. Code, § 2-302.) The most detailed and specific commentaries observe that a contract is largely an allocation of risks between the parties, and therefore that a contractual term is substantively suspect if it reallocates the risks of the bargain in an objectively unreasonable or unexpected manner. (Murray, *Unconscionability: Unconscionability* (1969) 31 U.Pitt.L.Rev. 1, 12-23; see also Eddy, *supra*, 65 Cal.L.Rev. at pp. 45-51; *Geldermann and Company, Inc. v. Lane Processing, Inc.*, *supra*, 527 F.2d at p. 576.) But not all unreasonable risk reallocations are unconscionable; rather, enforceability of the clause is tied to the procedural aspects of unconscionability (see *ante*, pp. 485-476 [sic]) such that the greater the unfair surprise or inequality of bargaining power, the less unreasonable the risk reallocation which will be tolerated. (See Spanogle, *supra*, 117 U.Pa. L.Rev. at pp. 950, 968.)" (*Id.*, at pp. 486-487.)

In this case, although the procedural aspects of unconscionability arguably are manifest, we find nothing

commercially or objectively unreasonable in the NSF charges actually imposed. The extent of the service charge imposed for the bank's handling of an NSF check was neither hidden nor unexpected, *but instead was concededly known to appellant before he wrote NSF checks.* Appellant could have easily avoided the NSF charge by simply refraining from writing checks on an account with insufficient funds. Under governing principles and in light of the total circumstances reflected in this record, we determine as a matter of law that the alleged disparity between the cost of processing and the charges actually imposed do not rise to the level of substantive unconscionability so as to deny enforcement of the service charge agreement.[2]

In conclusion, we hold that Crocker possessed a valid and enforceable contractual right to impose the particular NSF service charges alleged. Accordingly, the demurrer was properly sustained as to the first three causes of action.

II.

Appellant's fourth cause of action alleges unfair and deceptive business practices by Crocker in that depositors were not apprised that the signature card subjected them to NSF charges, and were led to believe the card was only a handwriting exemplar.[3] But the complaint fails to allege any ultimate facts indicating in what

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[2] We are not unmindful of the compelling policy arguments advanced by amici in support of appellant. Our decision is, of course, limited to the record before us and is itself subject to review. But the question of potential abuse in the form of expansive or indiscriminate charges is *not* before us; any corrective measures necessary to prevent such likelihood should be directed to the Legislature and not the courts.

[3] Unfair competition, proscribed by sections 17200-17208 of the Business and Professions Code, is defined to include an "unlawful, unfair or fraudulent business practice. . . ." (Bus. & Prof. Code, § 17200).

manner depositors were misled or deceived. As repetitively shown, the signature card explicitly recites the depositor's agreement to pay service charges, a fact openly acknowledged by appellant. Such facial inadequacy was vulnerable to a general demurrer; the order sustaining Crocker's demurrer thereto was clearly proper.

III.

In his fifth cause of action,[4] appellant complains that the NSF charges constitute unenforceable liquidated damages under the provisions of former Civil Code section 1670 (repealed by Stats. 1977, ch. 198, § 2, operative July 1, 1978; see now Civ. Code § 1671, as amended). The specific complaint is likewise unfounded.

As earlier noted, identical arguments were urged unsuccessfully in *Shapiro v. United California Bank*, *supra*, 133 Cal.App.3d 256, and *Hoffman v. Security Pacific Nat. Bank*, *supra*, 121 Cal.App.3d 964. We subscribe to the reasoning in those decisions that the standardized signature card did not include an implied promise by the depositor to refrain from writing NSF checks which would support a conclusion that the provision amounted to an unenforceable penalty. Rather, an NSF check is deemed to be an application for advance credit. Consequently, the issuance of an NSF check does not constitute a breach of contract and the provisions of former Civil Code section 1670 do not apply.

The judgment is affirmed.

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[4] The general demurrer to this count was sustained pursuant to stipulation.

CERTIFIED FOR PUBLICATION.

RACANELLI, P. J.

WE CONCUR:

ELKINGTON, J.

NEWSOM, J.

[Designation of counsel and trial court omitted]

APPENDIX D

[Designation of counsel omitted]

IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 740352

PAUL PERDUE, on behalf of himself and all others similarly situated,
Plaintiffs,

vs.

CROCKER NATIONAL BANK, and DOE 1 THROUGH DOE 100, INCLUSIVE,
Defendants.

[Filed July 3, 1978]

CLASS ACTION COMPLAINT FOR DECLARATORY AND INJUNCTIVE RELIEF AND DAMAGES

Plaintiff alleges:

FIRST CAUSE OF ACTION

DECLARATORY AND INJUNCTIVE RELIEF UPON THE GROUNDS THAT THE SIGNATURE CARD IS NOT A CONTRACT

1.

Plaintiff brings this action on behalf of all persons similarly situated pursuant to CAL. CODE CIV. PROC § 382, on the following grounds:

A. Each class member has a checking account with defendant and seeks declaratory and injunctive relief in addition to damages for charges imposed by defendant because of processing checks presented against insufficient funds. This class also includes a subclass which exists of persons who had accounts and paid the charge within the applicable period of limitations.

This class and subclass consist of individual members so numerous that joinder or other alternative proceedings are impractical. The names and addresses of class members are presently unknown to plaintiff, but can be readily ascertained from the defendant's business records. [Hereafter "plaintiff(s)" shall refer to the named plaintiff(s) as well as members of the class.]

B. The common or similar issues of law and fact which predominate over individual issues include, but are not limited to, the following:

1. Each member of the class has or had a checking account with defendant and the account has been charged for the processing of checks presented against insufficient funds.

2. The legal rights and obligations of the parties are identical concerning the imposition of the amount charged by defendant for processing checks presented against insufficient funds on plaintiffs' accounts.

3. Proof of common facts and legal doctrines by the representative plaintiff will determine the claims of each member of plaintiffs' class.

4. The class action proceeding will provide a practical basis for the determination of all interests of the parties, prevent inconsistent adjudications, maximize judicial economy, and is superior to all other available methods of fair and efficient adjudication of the controversy.

C. The named representative's claims are typical and representative of the class and subclass claims because

(s)he has a checking account and has paid the special handling charge.

D. The named representative will fairly and adequately represent and protect the class interests because her/his interests are neither adverse nor inconsistent with the class interest.

2.

Defendant CROCKER NATIONAL BANK is a banking association, doing business and maintaining branch offices in San Francisco.

3.

The true names, identies [sic] and legal capacities of the defendants sued herein as DOE 1 through DOE 100 are unknown to plaintiffs and therefore said defendants are sued by fictitious names under the provisions of CAL. CODE CIV. PROC. § 474. Each of said DOE defendants was an agent, principal, employer, employee, subsidiary, partner, associate, joint venturer or person exercising control of another defendant liable for the wrongful acts alleged herein. Each of said DOE defendants is legally responsible in some manner for the wrongful acts, injury and damages alleged herein.

4.

Banking transactions are subjected to closer scrutiny than ordinary commercial transactions by various regulatory bodies and the courts and defendants owe a duty of fair dealing toward plaintiffs.

5.

The possession and use of a checking account is a practical necessity for the plaintiffs.

6.

Defendants offer to the plaintiffs and the general public checking services. Defendants receive deposits of money

on behalf of the plaintiffs and, upon presentation of a check drawn by plaintiffs, disperse money as directed by the check.

7.

Defendants offer said checking services in exchange for a promise by plaintiffs to pay a predetermined charge set by defendants [hereafter called the "maintenance charge."] Plaintiffs, at the commencement of the checking account agreed to pay said maintenance charge, or to maintain a minimum balance in their checking account or some similar arrangement, unless such charge was waived. This maintenance charge is stated on periodic statements issued to the respective plaintiffs by the defendant.

8.

It is the practice of defendants to impose and collect a unilaterally set charge for processing checks presented against plaintiffs' accounts when such accounts do not contain sufficient funds to cover the amount of the check [hereafter called "NSF checks"]. This charge, imposed separately from and in addition to a maintenance charge for other regular checking activity, is hereafter referred to as the "NSF charge."

9.

Defendants, in fact, can and do off-set the amount of the NSF charge against any remaining balance in the account and do not have to bring suit or take any other affirmative action to collect the charge against plaintiffs' accounts.

10.

Defendants have at various times unilaterally increased the NSF charge to an amount the defendants deemed appropriate, without reference to any criteria, and defendants imposed and collected the said increased amount without any explanation or justification by defendants to plaintiffs.

11.

Defendants require of each plaintiff a signature upon an individual card. Attached as Exhibit 1 and incorporated by reference as though set forth in full is a copy of such card used by the defendants and called a signature card.

12.

The signature card is retained by the defendants and plaintiffs are not provided with a copy of the card.

13.

The defendants use the signature card to determine and verify the authenticity of endorsements on checks. For that purpose, the defendants require plaintiffs to submit an exemplar of their signatures on the signature card.

14.

The signature card prepared by the defendants does not identify the amount of any charge to be paid by the plaintiffs for processing NSF checks and is not an agreement for such payment. The card does not constitute mutual assent to NSF charges in any particular sum or at all and accordingly is not a contract conferring authority to do the acts complained of herein.

15.

Based upon the language of the signature card, the plaintiffs believed and expected that the signature card was intended as a handwriting exemplar for purposes of identification and verification only.

16.

In the course of checking account activity by the plaintiffs, certain checks of plaintiffs have been and will be presented which exceed the amount then on deposit in their respective accounts.

17.

Defendants anticipate that plaintiffs will cause checks to be presented against insufficient funds in their accounts and defendants impose a charge for each NSF check presented whether returned or honored. Said charge is $6.00. Attached as Exhibit 2 is a true copy of a notice of said charge to the named plaintiff.

18.

Plaintiffs allege, upon information and belief, that the actual cost incurred by the defendants in processing an NSF check is approximately $0.30, which cost was at all times known to the defendants.

19.

Plaintiffs have performed all conditions required of them, except as performance is excused or waived, relating to the checking account with the defendants.

20.

A present and actual controversy exists between the plaintiffs and the defendants concerning their respective rights and obligations. A controversy exists as to whether the signature card is a valid or enforceable contract and whether said signature card is a lawful basis for the imposition of the NSF charge. Plaintiffs contend that the signature card is not a contract and that the endorsement of the signature card by the plaintiffs—given its language, form and appearance—does not create a legal and binding contract for the defendants' authority to impose the NSF charge. Defendants contend that the signature card is a valid and enforceable contract and that it provides the lawful authority to impose and collect the NSF charge.

21.

Plaintiffs desire a judicial determination of the nature, scope, force and effect of the relationship created by the

signature card. Declaratory relief is both necessary and appropriate to resolve this question. Unless enjoined, defendants will continue to do the acts complained of and declared to be improper.

SECOND CAUSE OF ACTION:

DECLARATORY AND INJUNCTIVE RELIEF BASED UPON THE GROUNDS THAT THE SIGNATURE CARD IS ILLUSORY, AMBIGUOUS AND AN OPPRESSIVE CONTRACT OF ADHESION

22.

Plaintiffs hereby incorporate Paragraphs 1 through 13 and Paragraphs 15 through 19 as though fully set forth herein.

23.

The signature card used by defendants to conduct their part of the checking account relationship is prepared and drafted and imposed by defendants in a standard form.

24.

A disparity in bargaining power exists between plaintiffs and the defendants in favor of the defendants. The relative economic power, knowledge, experience, resources and expertise of the defendants in the checking account relationship relegates the plaintiffs to an inferior bargaining position at all stages of such relationship.

25.

Plaintiffs must acquiesce in the checking account relationship exactly as it is offered by the defendants. Plaintiffs are further forced to accept a similar arrangement with other banks, or to forego checking services.

26.

The language of the signature card is illusory in that, among other things, it fails to commit the defendants to

any obligation, duty or responsibility. The language of the signature card reserves the right to defendants to alter, at any time, any aspect of the checking account relationship, including the absolute right by defendants to terminate the account without prior notice and to set or alter the amount at any level of any charges including the NSF charge. The defendants have unilaterally increased the amount of the NSF charge from time to time, and have terminated accounts of plaintiffs without prior notice to such plaintiffs.

27.

The signature card is drafted by defendants in a manner not adequate to create any enforceable contract right to impose or collect the NSF charge.

28.

The signature card is ambiguous, vague and uncertain as to whether it is an identification card or, as defendants contend, a valid and enforceable contract to impose and collect the NSF charge.

29.

The conduct and practice of defendants occasionally to advance monies to the plaintiffs by honoring NSF checks, in the sole discretion of the defendants, has resulted in ambiguity, confusion and uncertainty as to the rights and obligations of the plaintiffs in handling of their checking accounts and as to the meaning of the signature card.

30.

The disparity between the actual cost to defendants and the amount charged by defendants for processing an NSF check unreasonably and oppressively imposes excessive and unfair liability upon plaintiffs.

31.

A present and actual controversy exists between the plaintiffs and the defendants concerning their respective

rights and duties as to whether: (A) Any obligation of plaintiffs to pay NSF charges pursuant to any language of the signature card is unenforceable because defendants claim the power to and do alter or terminate the arrangement at will; (B) Plaintiffs are not obligated to pay the NSF charge pursuant to the signature card because it is adhesive and does not unambiguously provide therefor; (C) Defendants lack lawful authority pursuant to the signature card to impose the NSF charge because the NSF charge is an oppressive and unreasonable imposition of liability upon plaintiffs which does not reflect the actual cost to defendants for processing the NSF check. Defendants assert that the NSF charge is authorized by the signature card; plaintiffs contend that the signature card confers no such authority.

32.

Plaintiffs desire a judicial determination of their rights and duties and a declaration as to whether or not the NSF charge is authorized and enforceable by virtue of the signature card. A judicial declaration is necessary and appropriate so that plaintiffs may ascertain their rights and duties. Unless enjoined, defendants will continue to do the acts complained of and declared to be improper.

THIRD CAUSE OF ACTION

UNJUST ENRICHMENT

Plaintiffs hereby incorporate Paragraphs 1 through 10, 16 through 19, 23 through 25, and 30 as though fully set forth herein.

33.

If plaintiffs prevail on either the First or Second Cause of Action, then the defendants' imposition of the NSF charge on plaintiffs' checking accounts has resulted in the payment of substantial sums of money to defendants, which amounts properly belong to plaintiffs, and which

amounts constitute an unjust enrichment to the defendants to the extent said sums exceed the actual processing costs of NSF checks.

34.

Defendants continue to retain said funds.

35.

Plaintiffs have been damaged by reason of defendants' imposition and retention of the NSF charges in an amount not known to plaintiffs but known to defendants.

36.

Plaintiffs request that the amounts retained by defendants that constitute an unjust enrichment be returned as damages to the plaintiffs.

FOURTH CAUSE OF ACTION

UNFAIR, DECEPTIVE AND MISLEADING BUSINESS PRACTICES

37.

Plaintiffs hereby incorporate Paragraphs 1 through 18 and Paragraphs 23 through 30 as though fully set forth herein.

38.

Said signature card is used in a manner which is unfair, deceptive and misleading, in that plaintiffs are led to believe that it is a signature card for identification purposes and the defendants treat the signature card, without disclosure of said fact, as the legal authority to impose the NSF charge on plaintiffs' checking accounts.

39.

From time to time, defendants arbitrarily and capriciously waive the NSF charge for preferred or commercial accounts. Said waiver is a further unfair business prac-

tice because it forces plaintiffs, who have had their accounts charged, to shoulder the cost that the defendants incur for processing NSF checks of others at the expense of plaintiffs to the benefit of the preferred customers.

40.

Defendants' practices are likely to deceive and have deceived plaintiffs and other members of the public in violation of CAL. BUS. & PROF. CODE §§ 17200 *et seq.* Unless enjoined, said conduct will continue.

FIFTH CAUSE OF ACTION

CIVIL CODE § 1670

41.

Plaintiffs hereby incorporate Paragraphs 1 through 9, 11, 13, 16, 17, 18, 23, 24, 25 and 30 as though fully set forth herein.

42.

Causing NSF checks to be presented for payment is a breach by plaintiffs of their contractual obligations to defendants to refrain from causing NSF checks to be presented for payment or to maintain a positive account balance.

43.

Defendants' imposition of the NSF charge is a penalty and is not imposed to compensate defendants for damages incurred by plaintiffs' breach by causing the presentation of NSF checks and is therefore an unlawful charge.

44.

The imposition of said charge by defendants is a violation of and is contrary to the express provisions of CAL. CIV. CODE § 1670 and is not exempted therefrom by CAL. CIV. CODE § 1671.

45.

From actual experience and knowledge, defendants can determine the actual pro rata cost of NSF checks. On information and belief, said cost is approximately thirty ($0.30) cents.

46.

Plaintiffs are entitled to recover the difference between the unlawful charges collected and defendants' actual damages sustained.

PRAYER

Plaintiffs request the following relief:

1. Declaratory relief whether the signature card is a valid and enforceable contract and

(a) if so, what the rights and obligations of the parties are thereunder and for an injunction against any conduct complained of herein not authorized thereunder;

(b) if not, for an injunction against any claim or use by defendants thereof as the authority for imposing NSF charges;

2. An accounting of all NSF charges and for a determination as to how much thereof must be refunded to plaintiffs;

3. An injunction against all unfair business practices found to exist;

4. Reformation of the signature card in accordance with the declaratory and injunctive relief granted;

5. An order enjoining the defendants from imposing an NSF charge in excess of defendants' actual costs of processing an NSF check;

6. An order requiring defendants to advertise to and advise the public and plaintiffs of their rights and obliga-

tions concerning the checking account practices of the defendants;

7. Reasonable attorneys' fees and costs of suit; and

8. Such other relief as is just and proper.

DATED: June 27, 1978.

GARY J. NEAR
KIPPERMAN, SHAWN, KEKER & BROCKETT

By _____
STEVEN M. KIPPERMAN
Counsel for Plaintiffs.

[Exhibit 1 and Exhibit 2 have been omitted. Exhibit 1 is a notice of advice of charges for special services—checking account. Exhibit 2 is an exemplar of appellant's deposit account signature card contract.]

APPENDIX E

ORDER DUE
August 16, 1985

ORDER DENYING REHEARING
IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

SF No. 24591

PERDUE,

Appellant

v.

CROCKER NATIONAL BANK,

Respondent

KAUS, J. AND GRODIN, J., DID NOT PARTICIPATE.

[Filed Aug. 15, 1985]

IN BANK

Respondent's petition for rehearing DENIED.

/s/ Bird
Chief Justice

APPENDIX F

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

SF No. 24591

1 Civil No. A013838
Superior Court No. 740352

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

[Filed September 5, 1985]

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that CROCKER NATIONAL BANK, the defendant above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of California entered herein on July 18, 1985, sustaining the validity of state statutes, including California Civil Code § 1670.5, against the claim that they are repugnant to the Constitution, treaties or laws of the United States.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: September 5, 1985.

/s/ William Alsup
WILLIAM ALSUP
MORRISON & FOERSTER
One Market Plaza
Spear Street Tower
San Francisco, CA 94105
Telephone: (415) 777-6000

Attorneys for
Defendant-Respondent
CROCKER NATIONAL BANK

[Affidavit of service by mail and service list deleted]

APPENDIX G

12 U.S.C. § 24

Corporate powers of associations

Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

* * * *

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits . . . .

* * * *

12 U.S.C. § 484

Limitation on visitorial powers

(a) No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

(b) Notwithstanding subsection (a) of this section, lawfully authorized State auditors and examiners may, at reasonable times and upon reasonable notice to a bank, review its records solely to ensure compliance with applicable State unclaimed property or escheat laws upon reasonable cause to believe that the bank has failed to comply with such laws.

APPENDIX H

12 U.S.C. § 3501

Congressional findings and declaration of purpose

(a) The Congress hereby finds that—

(1) limitations on the interest rates which are payable on deposits and accounts discourage persons from saving money, create inequities for depositors, impede the ability of depository institutions to compete for funds, and have not achieved their purpose of providing an even flow of funds for home mortgage lending; and

(2) all depositors, and particularly those with modest savings, are entitled to receive a market rate of return on their savings as soon as it is economically feasible for depository institutions to pay such rate.

(b) It is the purpose of this subchapter to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts by depository institutions by extending the authority to impose such limitations for 6 years, subject to specific standards designed to ensure a phase-out of such limitations to market rates of interest.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 202, 94 Stat. 132, 142]

12 U.S.C. § 3502

Depository Institutions Deregulation Committee

(a) Transfer of statutory authorities

The authorities conferred by sections 371b, 1425b (a), and 1828(g) of this title or by any other

provision of Federal law, other than section 1763 of this title, to prescribe rules governing the payment of interest and dividends and the establishment of classes of deposits or accounts, including limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts, and the authority conferred by the provisions of section 102 of Public Law 94-200 (12 U.S.C. 461 note) are hereby transferred to the Depository Institutions Deregulation Committee (hereinafter in this subchapter referred to as the "Deregulation Committee").

(b) Membership; meetings; voting

The Deregulation Committee shall consist of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, the Chairman of the Federal Home Loan Bank Board, and the Chairman of the National Credit Union Administration Board, who shall be voting members, and the Comptroller of the Currency who shall be a nonvoting member of the Deregulation Committee. The Deregulation Committee shall hold public meetings at least quarterly. All meetings of the Deregulation Committee shall be conducted in conformity with the provisions of section 52b of title 5. The Deregulation Committee may not take any action unless such action is approved by a majority vote of the voting members of the Deregulation Committee.

(c) Delegation of authorities prohibited

The authorities conferred by this subchapter on the Deregulation Committee and its members may not be delegated.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 203, 94 Stat. 132, 142]

12 U.S.C. § 3503

Phase-out and elimination of limitations, and gradual increases of maximum rates of interest and dividends paid on deposits and accounts

(a) Exercise of authorities; methods employed

The Deregulation Committee shall, by regulation, exercise the authorities transferred by section 3502 of this title to provide for the orderly phase-out and the ultimate elimination of the limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts as rapidly as economic conditions warrant. The phase-out of such limitations may be achieved by the Deregulation Committee by the gradual increase in such limitations applicable to all existing categories of accounts, the complete elimination of the limitations applicable to particular categories of accounts, the creation of new categories of accounts not subject to limitations or with limitations set at current market rates, any combination of the above methods, or any other method.

(b) Maximum amounts of increases

The Deregulation Committee shall work toward providing all depositors with a market rate of return on their savings with due regard for the safety and soundness of depository institutions. Pursuant to the authority granted by this subchapter, the Deregulation Committee shall increase all limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts to market rates as soon as feasible, except that the Deregulation Committee shall not increase such limitations above market rates during the six-year period beginning on March 31, 1980.

(c)(1) Money market deposit accounts; authorization; competitiveness with money market mutual funds; limitations on maximum rate of interest barred; transaction account reserves requirement inapplicable

The Committee shall issue a regulation authorizing a new deposit account, effective not later than 60 days after October 15, 1982. Such account shall be directly equivalent to and competitive with money market mutual funds registered with the Securities and Exchange Commission under the Investment Company Act of 1940 [15 U.S.C. § 80a-1 et seq.].

(2) No limitation on the maximum rate or rates of interest payable on deposit accounts shall apply to the account authorized by this subsection.

(3) For purposes of section 461(b) of this title, accounts established pursuant to this subsection which are not "transaction accounts" as defined by the reserve requirement regulations of the Board of Governors of the Federal Reserve System as those regulations existed on August 1, 1982, shall not be subject to transaction account reserves, even though no minimum maturity is required, and even though up to three preauthorized or automatic transfers and three transfers to third parties are permitted monthly.

(4) The transitional adjustment provisions in section 461(b)(8) of this title, providing for the phase-in of reserve requirements, shall not apply to an account established pursuant to this subsection.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 204, 94 Stat. 132, 143; Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, Title III, § 327, 96 Stat. 1469, 1501]

12 U.S.C. § 3504

Voting requirements respecting targets for limitations on maximum rates of interest and dividends paid on deposits and accounts and phase-out of interest rate controls; adjustment of limitations

(a) In order to assist the Deregulation Committee in establishing the limitations on the maximum rates of interest and dividends which may be paid on all deposits and accounts at market rates as soon as feasible and in order to provide maximum assurance that interest rate controls will be phased-out during the 6-year period following March 31, 1980, the Deregulation Committee shall vote, not later than 18 months after March 31, 1980, on whether to increase the limitations on the maximum rates applicable to passbook and similar savings accounts by at least one-fourth of one percentage point during such 18-month period, and shall vote, not later than the end of the third, fourth, fifth, and sixth years after March 31, 1980, on whether to increase the limitations on the maximum rates applicable to all categories of deposits and accounts by at least one-half of one percentage point.

(b) The Deregulation Committee may, consistent with the purposes of this subchapter, adjust the limitations on the rates applicable to all categories of deposits and accounts to rates which are higher or lower than the targets set forth in this section.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 205, 94 Stat. 132, 143]

12 U.S.C. § 3505

Reporting requirements for individual members of Deregulation Committee; contents

Each member of the Deregulation Committee shall separately report to the Congress annually after

March 31, 1980 regarding the economic viability of depository institutions. Each such report shall contain—

(1) an assessment of whether the removal of any differential between the rates payable on deposits and accounts by banks and those payable by thrift institutions will adversely affect the housing finance market or the viability of the thrift industry;

(2) recommendations for measures which would encourage savings, provide for the equitable treatment of small savers, and ensure a steady and adequate flow of funds to thrift institutions and the housing market;

(3) findings concerning disintermediation of savings deposits from insured banks and insured thrift institutions to uninsured money market innovators paying market rates to savers; and

(4) recommendations for such legislative and administrative actions as the member involved considers necessary to maintain the economic viability of depository institutions.

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title II, § 206, 94 Stat. 132, 143-44]

12 U.S.C. § 1832

Withdrawals by negotiable or transferable instruments for transfers to third parties

(a) Authority of depository institution; applicability

(1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable

instruments for the purpose of making transfers to third parties.

(2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit, and with respect to deposits of public funds by an officer, employee, or agent of the United States, any State, county, municipality, or political subdivision thereof, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, Guam, any territory or possession of the United States, or any political subdivision thereof.

* * * *

[Depository Institutions and Monetary Control Act of 1980, Pub. L. No. 96-221, Title III, § 303, 94 Stat. 132, 146]

APPENDIX I

48 Fed. Reg. 54319 (1983)

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 7

[Docket No. 83-53]

Interpretive Ruling Concerning
National Bank Service Charges

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: This interpretive final rule clarifies the position of the Office regarding the ability of national banks to levy charges relating to services performed for customers in connection with deposit accounts. This action is necessary to incorporate into the service charge ruling interpretations which have been rendered under that ruling and to clarify that state law which interferes with the ability of national banks to establish service charges is preempted. The intended effect of this action is to provide certainty to banks and customers alike regarding, respectively, their ability to impose, or liability for, service charges by national banks in connection with deposit accounts.

EFFECTIVE DATE: December 2, 1983.

FOR FURTHER INFORMATION CONTACT: Jerome Edelstein, Attorney, Legal Advisory Services Division, [202] 447-1880, Office of the Comptroller of the Currency, Washington, D.C. 20219.

SUPPLEMENTARY INFORMATION:

Background

The Office is updating its interpretive ruling, 12 CFR 7.8000, regarding the imposition of service charges by national banks. This action is taken in response to disputes, including litigation, which have arisen over deposit account service charges by national banks. Clarification is particularly important at this time in light of current competitive conditions and the lifting of interest ceilings on certain deposit accounts. These changes underscore the need for banks to have flexibility to develop pricing policies to serve their corporate and competitive needs. Thus, the Office is codifying and clarifying certain principles relevant to the imposition of service charges by national banks. It is expected that this codification will provide needed certainty in this area.

Discussion

The ruling adds the following provisions to the current interpretive ruling. First, the final rule restates the longstanding Office position that the establishment of deposit account service charges and the amounts thereof are business decisions properly made by bank management for which the Office does not substitute its judgment. Second, the ruling makes it clear that in setting deposit account service charges, national banks may consider, but are not limited to considering:

—Recovering costs incurred by the bank in providing the service, plus a profit margin. Absent the ability to recover such costs and receive a profit, banks may be unwilling to provide a given service, thus limiting competition and customer choices.

—Deterring of misuse by borrowers. Certain deposit account services provided by banks, such as the honoring of checks drawn against nonsufficient funds, have

the potential for misuse. It has been the Office position that service charges should discourage customers from frequently writing checks in amounts greater than their account balances. Such a practice, if left uncontrolled, provides a customer with automatic loans. Alternatively, the bank could automatically dishonor all checks drawn on nonsufficient funds. A bank, however, may hesitate to do this because of the embarrassment to its customer. An appropriate option, the Office believes, is to establish service charges to be levied in connection with the writing of nonsufficient fund checks by borrowers to discourage customers from frequently writing such checks.

—Enhancing of the competitive position and the marketing strategy of the bank. It is the position of the Office that banks should have the ability to set service charges to encourage or discourage the use of certain services in line with the bank's goals and corporate requirements.

—Maintaining of safety and soundness. Service charges should always be established with consideration of their impact on the financial health and profitability of the bank.

Third, the ruling clarifies that in accordance with general principle [sic] of federal preemption of state law, the amounts of deposit account service charges may not be limited, restricted or prohibited by state law. State law that tends to impair the efficiency of national banks or conflicts with the paramount laws of the United States is preempted. State laws which limit, restrict, or prohibit the amounts of deposit account service charges by national banks impair the ability of national banks to exercise their authority to take deposits under 12 U.S.C. 24 Seventh. Also, deregulation, including the lifting of interest rate ceilings on numerous types of accounts, underscores the need for national banks to have flexibility in the establishment of deposit account service

charges so that they may continue to pay depositors market rates of interest. Further, the safety and soundness of banks depends in significant part on their ability to devise price structures appropriate for their needs. Any state law impediments to national bank flexibility have potentially serious implications for their continued safety and soundness. In such circumstances, the authority to regulate has been given by Congress to this Office as part of its mission of monitoring the safety and soundness of the national banking system. Attempts by states to regulate in the area are preempted as being in conflict with the statutory scheme under which the national banking system is regulated.

Title 12 CFR 7.8000 is not applicable to service charges imposed by a national bank in its capacity as a fiduciary. Those charges continue to be governed by 12 CFR Part 9. Title 12 CFR 7.7515, relating to service charges on dormant accounts, and 12 CFR 7.7517, relating to checking charges by newly organized national banks, remain in effect. The Office is considering amendments to these interpretive rulings and may develop a separate rulemaking proceeding concerning national bank service charges.

Special Studies

A Regulatory Flexibility Analysis under the Regulatory Flexibility Act is not required for interpretive rulings such as this where a notice of proposed rulemaking is not required.

A Regulatory Impact Analysis is not required because the OCC has determined that the rule is not a "major rule" as defined by Executive Order 12291.

Notice and Comment

Publication for notice and comment and delayed effectiveness as set forth in the Administrative Procedure

Act 5 U.S.C. § 553 are not required for this document which is an interpretive rule and therefore is exempt (5 U.S.C. 553(b)(A), (d)(2)).

List of Subjects in 12 CFR Part 7

National banks, Service charges, Deposit accounts.

PART 7—[AMENDED]

Accordingly, for the reasons set forth above, Part 7 is amended by revising § 7.8000 as follows:

1. The authority citation for Part 7 reads as follows:

Authority: R.S. 324 et seq., as amended; 12 U.S.C. 1 *et seq.*, unless otherwise stated.

2. By revising 12 CFR 7.8000 as follows:

§ 7.8000 Charges by national banks.

(a) All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or discussion with other banks or their officers.

(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision made by each bank and the Office will not substitute its judgment. In establishing deposit account service charges, the bank may consider, but is not limited to considering:

(1) Costs incurred by the bank, plus a profit margin, in providing the service;

(2) The deterrence of misuse by customers of banking services;

(3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy;

(4) Maintenance of the safety and soundness of the institution.

(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the amount of that charge. Those laws impair the efficiency of national banks and conflict with the regulatory scheme governing the national banking system and are preempted by federal law.

(d) This interpretive ruling does not apply to (1) charges imposed by a national bank in its capacity as a fiduciary, which are governed by 12 CFR 9; and (2) service charges on dormant accounts which are governed by 12 CFR 7.7515.

Dated: November 28, 1983.

C. T. Conover,

Comptroller of the Currency.

49 Fed. Reg. 28237 (1984)

DEPARTMENT OF THE TREASURY

Comptroller of the Currency

12 CFR Part 7

[Docket No. 84-23]

Interpretive Ruling Concerning National Bank Service Charges

AGENCY: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: This interpretive final rule amends an earlier interpretive ruling of the Office published on December 2, 1983. This amendment is necessary to clarify some misperceptions regarding the ruling. There is a misunderstanding on the part of some that the ruling itself preempts state laws regarding national bank service charges on deposit accounts. One of the purposes of this amendment is to make clear that this is not the case. Rather, the Office believes that the comprehensive federal statutory scheme enacted by Congress over the years, together with more recent legislative actions deregulating bank deposits, leave no room for states to impose restrictions on national bank deposit account service charges. Some have also expressed concern that the ruling would permit any and all levels of pricing. This amendment additionally makes clear that the Office has the authority to deal with instances of unacceptable pricing.

EFFECTIVE DATE: July 11, 1984.

FOR FURTHER INFORMATION CONTACT: Alan Priest, Attorney, or Joseph Daly, Attorney, Legal Advisory Services Division, (202) 447-1880, Office of the Comptroller of the Currency, Washington, D.C. 20219.

SUPPLEMENTARY INFORMATION:

Background

On December 2, 1983, the Office updated its interpretive ruling, 12 CFR 7.8000 (48 FR 54319), regarding the imposition of service charges by national banks. The ruling was updated in three respects. First, the final rule restated the longstanding Office position that the establishment of deposit account service charges and the amounts thereof are business decisions properly made by bank management. Second, the ruling made clear that in setting deposit account service charges, national banks may consider, but are not limited to considering:

—Recovering costs incurred by the bank in providing the service, plus a profit margin. Absent the ability to recover such costs and receive a profit, banks may be unwilling to provide a given service, thus limiting competition and customer choices.

—Deterring misuse by borrowers. Certain deposit account services provided by banks, such as the honoring of checks drawn against nonsufficient funds, have the potential for misuse. It has been the Office position that service charges should discourage customers from frequently writing checks in amounts greater than their account balances. Such a practice, if left uncontrolled, provides a customer with automatic loans. Alternatively, the bank could automatically dishonor all checks drawn on nonsufficient funds. A bank, however, may hesitate to do this because of the embarrassment to its customers. An appropriate option, the Office believes, is to establish service charges to be levied in connection with the writing of nonsufficient fund checks by borrowers to discourage customers from frequently writing such checks.

—Enhancing the competitive position and the marketing strategy of the bank. It is the position of the Office

that banks should have the ability to set service charges to encourage or discourage the use of certain services in line with the bank's goals and corporate requirements.

—Maintaining safety and soundness. Service charges should always be established with consideration of their impact on the financial health and profitability of the bank.

Third, the rule stated our opinion that federal law preempts state laws that prohibit or limit service charges on deposit accounts, with specified exceptions.

Two phrases in the existing rule have created confusion and uncertainty. First, the language in subsection (b) that "the Office will not substitute its judgment" has been misconstrued to mean that the Office will not review the level of service charges imposed by banks. That was not the intent, and the apparently misleading language is amended by this final rule. The Office fully recognizes its statutory, regulatory, and supervisory authority and responsibility to deal with instances of improper banking practices. The Office will continue to review all banking practices, primarily through its examination process, and to take appropriate action when warranted.

Second, the preemption language in subsection (c) has been misconstrued to imply that the interpretive ruling itself preempts state law. That is not the opinion of the Office regarding either the state of the law or the effect of the interpretive ruling. Language has been added to the rule indicating that it is the comprehensive federal statutory scheme governing the deposit-taking function of national banks (including recent federal laws deregulating deposit accounts) that preempts state laws that prohibit or limit the amount of a national bank's deposit account service charges.

Special Studies

A Regulatory Flexibility Analysis under the Regulatory Fexibility Act is not required for interpretive rulings such as this where a notice of proposed rulemaking is not required.

A Regulatory Impact Analysis is not required because the Office has determined that the rule is not a "major rule" as defined by Executive Order 12291.

Notice and Comment

Publication for notice and comment and delayed effectiveness as set forth in the Administrative Procedure Act 5 U.S.C. 553 are not required for this document which is an interpretive rule and therefore is exempt (5 U.S.C. 553(b)(A), (d)(2)).

List of Subjects in 12 CFR Part 7

National banks, Service charges, Deposit accounts.

PART 7—[AMENDED]

Accordingly, for the reasons set forth above, Part 7 is amended by amending § 7.8000 as follows:

1. The authority citation for Part 7 reads as follows:

Authority: R.S. 324 *et seq.*, as amended; 12 U.S.C. 1 et seq., unless otherwise stated.

2. By revising paragraphs (b) and (c) of 12 CFR 7.8000 as follows:

§ 7.8000 Charges by national banks.

* * * * *

(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision to be made by each bank according to sound banking judgment and federal standards of safety and soundness. In es-

tablishing deposit account service charges, the bank may consider, but is not limited to considering:

(1) Costs incurred by the bank, plus a profit margin, in providing the service;

(2) The deterrence of misuse by customers of banking services;

(3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy;

(4) Maintenance of the safety and soundness of the institution.

(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the amount of that charge. Such state laws are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks.

* * * * *

Dated: March 19, 1984.

C. T. Conover,

Comptroller of the Currency.

APPENDIX J

Comptroller's Handbook For National Bank Examiners

Introduction

General Introduction Section 1.1

This handbook is designed to aid the examiner in planning and conducting bank examinations. Although it discusses selected areas of banking in general terms, it is primarily oriented toward describing examination procedure and should not be viewed as a comprehensive training guide. Separate training programs covering every area in this handbook will provide more detailed instructions to assist the examiner in better understanding banking operations and the application of the examination procedures. The overall objective of the handbook is to organize and formalize long-standing examination objectives and procedures that will provide guidance to the examiner and enhance the quality and consistent application of examination procedures. Accordingly, this handbook provides specific guidelines for:

- Determining the scope of general and specialized examinations.
- Determining the procedures to be used in the examination of all areas of a bank, including those that may lead to the early detection of trends which, if continued, might result in a deterioration in the condition of a bank.
- Evaluating the adequacy of the bank's written policies and procedures, the degree of compliance with them, and the adequacy of its internal controls.
- Evaluating work performed by internal and external auditors.

- Evaluating the performance and activities of management and the board of directors.
- Preparing working papers that support examination reports and aid in the evaluation of work perfermed.
- Using objective criteria as a basis for an overall conclusion and resulting comments and criticisms of the condition and quality of the bank and its management.

The Office of the Comptroller of the Currency (OCC) is responsibile for promoting and assuring the soundness of the country's system of national banks. The bank examination process is the OCC's fact-finding arm in discharging that responsibility. The essential objectives of an examination are: (1) to provide an objective evaluation of a bank's soundness; (2) to permit the OCC to appraise the quality of management and directors; and (3) to identify those areas where corrective action is required to strengthen the bank, to improve the quality of its performance, and to enable it to comply with applicable laws, rulings and regulations. The evaluation of the prudency of practices, adherence to laws and regulations, adequacy of liquidity and capital, quality of assets and earnings, nature of operations, and adequacy of internal control and internal audit are among the procedures utilized to accomplish those objectives.

Although everything that either weakens or has the potential to weaken the condition of any national bank is of interest to and should receive the attention of the OCC and its staff, the primary concern of the former is the soundness of the National Banking System. Under ideal circumstances, therefore, the examiner's role is to make a qualitative analysis of the condition of the bank under examination. Accordingly, the scope of an examination may embrace every phase of banking activity, or it may concentrate on specific areas which deserve greater em-

phasis because of their potential impact on a bank's soundness.

* * * *

The handbook should also serve as a working tool rather than a reference manual. Examination procedures, verification procedures and internal control questionnaires are excerpted directly from the handbook to form the work programs used to examine a particular bank.

* * * *

Bank management, bank directors and the OCC all have individual and unique responsibilities to the National Banking System. The procedures in this handbook are consistent with an overall program that encourages those parties to meet their responsibilities. The role of the OCC as a supervisory agency and the nature of bank operations form the foundation for the material in each section.

* * * *

Deposit Accounts

Introduction Section 301.1

Deposits represent funds which bank customers have advanced and the bank is obligated to repay on demand or after a specific period of time. Deposits are the major source of employable funds available to a bank, therefore, it is important for a bank's management to implement programs to retain and expand the bank's deposit base and to monitor its character and volatility.

Bankers place great significance on deposit growth and structure since favorable operating results are dependent, in part, on an expanding, stable deposit base. Because of competition for funds, the need of most individuals and corporations to minimize idle funds and the effect of disintermediation on a bank's deposit base, bank management must adopt and implement a development and retention program for all types of deposits. Management must also establish a procedure for determining the volatility

and the character of the deposit structure so that funds can be employed properly while accommodating their potential for withdrawal.

The examination process will analyze the deposit development and retention program and methods used to determine the volatility and character of the deposit structure.

The deposit development and retention program includes:

- A marketing strategy.
- Projections of deposit structure and associated costs.
- A formula for comparing results against projections.
- A system for revising the plan when necessary.

* * * *

The examiner analyzes the character of the overall deposit structure. The information gathered in the various examination procedures should be sufficient to allow the examiner to judge the character of both volatile and hard core deposits. It is important that bank management be informed of the character of the deposit structure on a periodic basis by internal reports. Management's lack of such knowledge, could lead to the unwise employment of funds with problems arising at a later, inopportune date. Ultimately, the examiner should be satisfied that management has properly planned for the bank's future.

It would be impossible for an examiner to review each individual deposit account during the course of an examination. Accordingly, the examiner's efforts should be directed to those types of deposit accounts shown by experience to be most significant relative to the examination objectives. The following paragraphs discuss common types of deposit accounts that, under certain circumstances can become major problems.

* * * *

The size, frequency and duration of deposit account overdrafts are matters that should be governed by bank policy

and controlled by adequate internal controls, practices and procedures. Overdraft approval authority should be assigned in the same manner as is lending authority and should never exceed the employee's lending authority. Systems for monitoring and reporting overdrafts should emphasize a secondary level of administrative control that is distinct from other lending functions so that account officers who are less than objective do not allow influential customers to exploit their overdraft privileges. Overdraft charges should discourage frequency [sic] usage but penalty fees should never be considered an important source of income.

* * * *

Deposit Accounts

Examination Objectives Section 301.2

1. To determine if the policies, practices, procedures and internal controls regarding deposit accounts are adequate.

2. To determine if bank officers are operating in conformance with the established guidelines.

3. To evaluate the deposit structure and determine its character and volatility.

4. To determine the scope and adequacy of the audit function.

5. To determine compliance with applicable laws, rulings and regulations.

6. To initiate corrective action when policies, practices, procedures or internal controls are deficient or when violations of laws, rulings or regulations have been noted.

* * * *

Deposit Accounts

Examination Procedures Section 301.3

1. Complete or update the Deposit Accounts section of the Internal Control Questionnaire.
2. Based on the evaluation of internal controls and the work performed by internal/external auditors (see separate program) determine the scope of the examination.
3. Test for compliance with policies, practices, procedures and internal controls in conjunction with performing the remaining examination procedural steps. Also obtain a listing of any deficiencies noted in the latest review done by internal/external auditors from the examiner assigned "Internal and External Audits," and determine if appropriate corrections have been made.
4. Perform appropriate verification procedures.
5. Obtain or prepare, as applicable, the following listed reports. On an automated system, the examiner should use available bank copies of printouts plus transactions journals, microfiche or other visual media to minimize expense to the bank. The examiner should be guided by the minimum standards of output for data processing systems in deciding what information is available. On a manual system, the information necessary to complete the examination procedures and indicated verification procedures is left to the examiner's discretion.

   a. For demand deposits:

      - Trial balance.
      - Overdrafts.
      - Unposted items.
      - Dormant accounts.

- Public funds.
- Trust department funds.
- Uncollected funds.
- Due to banks.
- Average balance.
- Significant change.
- Demand certificates of deposits.
- Large balance report.

* * * *

10. Evaluate the effectiveness of procedures regarding overdrafts and drawings against uncollected funds by:

    a. Reviewing procedures and policies for extensions of credit by such methods to determine that:

        - Officer approval limits have been established.
        - A formal system of review and approval is in effect.

    b. Ascertaining the adequacy of the bank's policies and reporting methods regarding drawings against uncollected funds by determining that:

        - The uncollected funds report reflects balances as uncollected until they are actually received.
        - Management is effectively comparing reports of significant changes in balance and activity volume to uncollected funds reports.
        - Management knows the reasons why a depositor is frequently drawing against uncollected funds.
        - A reporting system to inform senior management of significant activity in this area has been instituted.

- Appropriate employees clearly understand the mechanics of drawing against uncollected funds and the risks involved, especially in the area of potential kiting operations.

c. Determining whether formal overdraft agreements exists and, if so:

- Obtain trial balance or list of the agreements.
- Cross-reference trial balance or list to credit line slips of various loan departments.
- Work credit files on significant formal agreements not crossed above.

d. Performing the following:

- Cross-reference overdraft and uncollected funds reports to credit line slips of the various loan departments.
- Work credit files on significant overdrafts and depositors who frequently draw significant amounts against uncollected funds not crossed above.
- Request management to charge uncollectable overdrafts to the reserve for possible loan losses.
- Submit a list of overdrafts considered loss and the total amounts overdrawn 15 days or more to the examiner assigned "Loan Portfolio Management."

11. Review the bank's deposit development and retention policy to determine if the scope includes:

a. A marketing strategy that includes:

- Advertising.
- Goods and services offered as inducements to potential deposit customers.

- Competitive rates.
- Indication of types of deposits desired, such as time and/or demand deposits of individuals, corporations or public entities.

b. Projections of anticipated deposit structure and interest costs of such a structure, indicating percentages of time and demand deposits of:

- Individuals.
- Corporations.
- Public entities.

c. A periodic comparison of performance to

- Estimated interest expense for new deposits and shifts from demand deposits.
- Service charge fee schedule.
- Estimated service charge income.
- Estimated processing costs.
- Changes in reserve requirements.

b. Comparing the volume of the automatic transfer accounts and resulting income and expenses to budgeted accounts. Significant variances should be investigated.

c. Preparing a memorandum for examiners performing "Funds Management" and "Analytical Review of Income and Expense" on the effects of automatic funds transfer accounts on the bank. This memorandum should address the following:

- Volume of new deposits.
- Significance of shifts in existing deposits attributable to the automatic funds transfer accounts.
- Income earned from service charges.

- Expenses incurred from processing entries to the accounts.
- Yields on assets funded by automatic transfer accounts.
- Accuracy and quality of management's planning regarding the service.

* * * *

17. Obtain information on competitive pressures and economic conditions from the examiner assigned "Overall Conclusions," and evaluate that information, along with current trends in deposits and present marketing techniques, to estimate their affect [sic] on the bank's deposit structure.

18. Test for compliance with applicable laws, rulings and regulations by performing the following for:

* * * *

i. *12 CFR 7.8000—Charges by Banks:*
Inquire into service charge calculations of competing banks to determine if charges in the marketing area are arrived at in a competitive manner.

* * * *

19. Discuss findings with appropriate officer(s) and prepare report comments on:

a. Policy deficiencies.

b. Weaknesses in supervision.

c. Apparent violations of laws, rulings and regulations and the potential personal liability of the directorate.

* * * *

Review the bank's internal controls, policies, practices and procedures for demand and time deposit accounts. The bank's systems should be documented in a complete and concise manner and should include, where appropri-

ate, narrative descriptions, flowcharts, copies of forms used and other pertinent information. Items marked with asterisks require substantiation by observation or testing.

* * * *

Overdrafts

22. Are officer overdraft limits formally established?

*23. Is an overdraft listing prepared daily?

*24. Is that listing circulated among the officers?

*25. Do overdrafts require the approval of an authorized officer?

26. Are the statements of larger overdrawn accounts reviewed for irregularities?

27. Is a record of overdrafts included in the monthly reports to the board of directors or its committee?

28. Is there an established schedule of service charges?

Other

* * * *

*34. For returned checks, unposted items and other rejects:

a. Are daily listings of such items prepared?

b. Are all items reviewed daily and is disposition of items required within a given time period (if so, indicate time period ————————)?

*35. For uncollected funds:

a. Does the bank receive or prepare a daily report of drawings against uncollected funds?

b. Does an authorized officer review that report?

c. Must an officer approve any draw against uncollected funds?

* * * *

Demand Deposit Conclusion

40. Is the foregoing information an adequate basis for evaluating internal control in that there are no significant additional internal auditing procedures, accounting controls, administrative controls or other circumstances that impair any controls or mitigate any weaknesses indicated above (explain negative answers briefly, and indicate conclusions as to their effect on specific examination or verification procedures)?

41. Based on a composite evaluation, as evidenced by answers to the foregoing questions and those relating to demand deposits included in the general section, internal control of demand deposits is considered ———— (good, medium or bad).

* * * *

Deposit Accounts

Verification Procedures Section 301.5

* * * *

2. Using appropriate techniques, sample the entire deposit structure as a single population and select deposits of all types from the trial balance . . . .

* * * *

3. For demand deposit accounts selected in step 2:

   a. Verify the computation of service charges for at least one account from each type of demand deposit account selected, and trace them to the appropriate income account.

   b. Determine, on a test basis, if insufficient funds and overdraft charges are properly collected and trace them to the appropriate income account.

* * * *

Overall Conclusions Regarding Condition of the Bank

Introduction — Section 503.1

Throughout this handbook, the examiner is encouraged to use objective criteria in evaluating various areas of the bank. However, there will always be a need for subjective judgment in an examination. Formulating an overall conclusion regarding the present and future condition of the bank requires the use of both objective criteria and subjective judgment. As experience is essential in evaluating information in areas requiring subjective judgment, the procedures in this section should be performed by the examiner-in-charge.

In performing those procedures, the examiner's primary concerns are:

- To make the ultimate determination as to:
  - The solvency of the bank and its ability to meet maturing and unusual demands in the ordinary course of business.
  - Adherence to safe and sound banking practice.
  - Adherence to the law.
  - The continued viability of the institution.
- To communicate the results of the examination to the Comptroller of the Currency and the directors of the bank.

The evaluation of the overall condition of the bank is based on conditions found throughout the institution. Considerations include internal control and policy exceptions; violations of law, rulings, and regulations; quality of management; adequacy of earnings and capital; quantities of criticized assets; and other identified deficiencies or irregularities.

An evaluation of the future condition of the bank is based on the analysis of:

- Management's plans as expressed by operating plans, the capital plan, and other projections.
- Factors such as competition and economic conditions.
- The overall present condition of the bank.

* * * *

Overall Conclusions Regarding Condition of the Bank

Examination Objectives Section 503.2

1. To reach conclusions regarding the present condition of the bank.
2. To reach conclusions regarding the future prospects of the bank.
3. To determine the bank's ability to meet demands in the ordinary course of business.
4. To determine the bank's adherence to safe and sound banking practices.
5. To formulate recommended action, when appropriate, based on those conclusions.
6. To communicate conclusions and recommendations both orally and in the examination report.

* * * *

Specialized Examinations and Supervisory Visitations

Introduction Section 700.1

Under 12 USC 481, the Office of the Comptroller of the Currency (OCC) has authority to examine national banks.

Examinations are meant to:

- Provide an objective evaluation of a bank's soundness.

- Permit the OCC to appraise the quality of management and directors.
- Identify areas where corrective action might be required to strengthen the bank, to improve the quality of its performance and to enable it to comply with applicable laws, rules and regulations.

The OCC believes that those objectives can be met on a timely basis through the use of two different types of examinations: General examinations and specialized examinations.

The general examination consists of the standard examination procedures outlined in this handbook. Since no two banks are exactly identical, national bank examiners, drawing on their professional judgment, may modify standard procedures contained in this handbook during general examinations.

The procedures developed for general examinations in the other sections of this handbook embrace every phase of banking activity. The OCC has decided that their periodic application in general examinations is necessary to properly discharge its duty in the administration and supervision of national banks. However, the OCC has decided that the use of those procedures in each examination is neither necessary nor desirable in most cases. In arriving at that decision, the OCC considered the benefit of the more extensive general examination procedures and the reliance that can be placed on the NBSS to identify changing situations in the banking industry and in individual banks. The OCC also recognized the benefits of periodic examinations of trust departments, EDP departments, international departments and consumer affairs in developing the minimum scope of the complimentary specialized examination.

* * * *

Specialized Examinations

Examination Procedures Section 700.3

1. Review the contents of this program and prepare a staff assignment and time budget. This should be done by the examiner-in-charge prior to starting the examination.
2. Review the working papers of previous general examination and any subsequent specialized examination.
3. Review the report for the most recent general examination and any subsequent specialized examination and:
   a. Determine that all significant deficiencies noted have been corrected or determine why corrective action was not initiated.

* * * *

22. For deposit accounts:
   a. Review the reconcilement of all types of deposit accounts including official checks. Compare the balances to department controls and the general ledger, and determine:
      - If reconciling items are reasonable.
      - The propriety of adjusting entries.
      - Disposition of reconciling items.
   b. Review recent reports of overdraft and drawings against uncollected funds and investigate any large, stale or repetitive items to determine loss potential.

* * * *

APPENDIX K

Cal. Civ. Code § 1670.5.

Unconscionable contract or clause of contract; finding as matter of law; remedies

(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

(Added by Stats. 1979, c. 819, p. 2827, § 3, eff. Sept. 19, 1979.)

APPENDIX L

[Cover page and tables omitted]

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Civil No. A013838

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

REPLY BRIEF OF AMICUS CURIAE COMPTROLLER OF THE CURRENCY WITH RESPECT TO THE COMPTROLLER'S INTERPRETIVE RULING

The Court has invited supplemental briefs on the subject of the effect of the amended version of the Comptroller of the Currency's Interpretive Ruling Concerning National Bank Service Charges, 12 C.F.R. 7.8000, promulgated on November 28, 1983.

Before addressing that subject, however, the Comptroller of the Currency thinks it appropriate first to inform the Court that, because there have been misperceptions and misunderstandings regarding the amended ruling, it is the Comptroller's intention to amend further and clarify the ruling so as to make clear the following points:

(a) that it is the federal statutory scheme and Congressional policy to deregulate in the area of

deposit-related banking services that preempts state law, and not the ruling itself;

(b) that the ruling should not be misconstrued as an encouragement to banks to raise prices without regard to prudent banking principles or in an anticompetitive manner; and

(c) that the Comptroller fully recognizes his obligation and authority to ensure that there be adequate protection at the federal level for banking consumers and will take all necessary and appropriate steps to provide consumers with means of redress in cases of egregiously uncompetitive pricing for deposit-related banking services.

This supplemental brief addresses three points: (1) the reason why the interpretive ruling, as amended, was promulgated; (2) the basis for the finding of preemption contained in the ruling; and (3) the effect the ruling has on courts adjudicating issues addressed by the ruling.

I. The Interpretive Ruling Was Promulgated As a Clear Public Statement by the Comptroller on the Subject of National Bank Service Charges.

As this Court is no doubt well aware, there have been a number of lawsuits filed within the past few years, both in the State of California and in other states, (*i.e.*, New York and Oregon) challenging under state law the imposition by national banks of service charges on deposit accounts, specifically charges for non-sufficient funds ("NSF") checks. Because of the amount of state-court litigation against national banks that has arisen on an issue that seems to the Comptroller to be one of a peculiarly federal nature, the Comptroller concluded that it was essential that he state, as a matter of public record, his position on this issue. Indeed, the ruling itself states: "This action is taken in response to disputes, including litigation, which have arisen over deposit account service charges by national banks."

Because the issue of NSF charges has become a focus of dispute and litigation, it is necessary for this Court, other courts faced with similar cases, national banks, and the banking public to be certain of the considered opinion of the Comptroller, as the Administrator of National Banks, on important principles relevant to the imposition by national banks of NSF and other deposit-related service charges. This Court has, of course, been apprised of the Comptroller's position on this issue through the *amicus* briefs filed in this case both in the Appellate Division and in this Court. The Comptroller there stated, and reaffirms here, that state law may not control or dictate the manner or exercise of the deposit-taking power of national banks, including the application of service charges. That is so because the existing federal legal framework has already occupied the field. If state law should be used in an attempt to exercise control over national banks in this area, that law would be preempted by the national banking statutory scheme enacted by Congress. The amended ruling does not say anything that had not already been said in those briefs.

The significance of the ruling for this Court, however, is not so much what the ruling says, as that the Comptroller chose to promulgate it in the first place. The act of promulgation is significant for two reasons. First, it was intended to demonstrate the Comptroller's firm commitment to the principles enunciated in the *amicus* briefs; this was not an *ad hoc* position taken simply to aid a defendant in a lawsuit, but a matter of importance to the entire national banking system. To demonstrate this, the Comptroller chose not simply to speak through briefs in a particular lawsuit, but to make a public pronouncement of general application. This underscores the fact that the Comptroller's stand in this case is not taken for the benefit of a particular bank, but for the well-being of the national banking system as a whole.

Indeed, the principle that underlies the Comptroller's ruling, that service charges should be determined by mar-

ket forecs and not by judicial rate-making, is a principle that was recognized by the Comptroller's office over twenty years ago. For example, in a letter to the Chairman of the Legal and Monetary Affairs Subcommittee of the Committee on Government Operations of the U.S. House of Representatives, dated November 5, 1963 (Appendix A hereto), Comptroller James J. Saxon said:

> This Office takes the position in regard to bank service charges that this is a matter to be governed by banking judgment as controlled by competitive factors in the arena in which the banks operate. If a particular bank imposes service charges that are too high, a rival bank would be able to take away a great deal of its business by offering a lower rate. Inasmuch as our society is grounded on the principle of free competition, strong competitors rather than government regulation in the local banking picture are the surest safeguards against arbitrary and unreasonable charges by an individual institution.

Second, the promulgation of the ruling reinforces the strong federal interest in the ability of national banks to exercise their federally granted deposit-taking authority free from interference by application of state law. It is important to recognize, moreover, that it is precisely because this is a matter of federal concern, and an area substantially occupied by Congress [1] and entrusted to the administrative purview of the Comptroller, that it was appropriate for the Comptroller to issue his ruling.

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[1] The Comptroller does not contend that state laws dealing with deposit-taking that do not intrude on Congressional intent to deregulate service charges for deposit accounts or that do not interfere with the banks' deposit-taking authority are preempted. For example, the Comptroller does not quarrel with the ruling in *Anderson National Bank v. Luckett*, 321 U.S. 233 (1944), where the Supreme Court held that a state statute on the treatment of dormant accounts was held applicable to national banks precisely because it did not interfere with the deposit-taking function of the banks.

There has been some suggestion by appellant and his allied *amici* herein that the interpretive ruling was promulgated for the purpose of attempting improperly to influence this Court or affect the outcome of this litigation. This allegation apparently finds its basis in the timing of the rule's publication, which took place shortly before the date of oral argument before the Court.

There was nothing sinister, or even dubious, in the timing of the promulgation of the rule. Surely, even those complaining must realize that such interpretive rulings do not spring into being overnight; indeed, the Comptroller had made the decision to issue such a ruling, and directed that its preparation be undertaken, some four months prior to its date of publication. The timing of its publication was due to the inevitable time-consuming tasks and procedures inherent in the routine drafting and review process common to all such administrative activities. Nevertheless, it was certainly the intention of the Comptroller to have the ruling a matter of public record prior to the date of oral argument before this Court since it was important for the Court in its consideration of this cause to understand that the Comptroller's stand as *amicus* herein is the policy of the Comptroller for administering all banks nationwide, consistent with Comptroller Saxon's pronouncement twenty years ago, and not merely a matter of convenience to a particular litigant.

II. The Interpretive Ruling Confirms the Comptroller's Position that State Law that Purports to or Has the Effect of Regulating Deposit-Related Service Charges by National Banks Is Preempted.

An important aspect of the interpretive ruling, one which has generated the most discussion in this forum, is the conclusion stated by the Comptroller in the ruling that the amounts of deposit-account service charges imposed by national banks may not be limited, restricted or prohibited by state law. This is so because attempts by

states to regulate in this area are preempted as being in conflict with the statutory scheme under which the national banking system is regulated.

The statement on preemption contained in the interpretive ruling should surprise no one, least of all the parties to the instant lawsuit, for it is precisely the same position taken by the Comptroller in his *amicus* briefs previously filed both in this Court and in the court below. The arguments in those two briefs are well known to the Court and will not be repeated here; it is sufficient here to note that the Comptroller's participation as *amicus* in this case has been for the specific purpose of presenting to the Court sound arguments why state law is preempted insofar as it purports or is used to regulate the amount of the service charges that national banks may impose on deposit accounts. The interpretive ruling reaffirms those very same arguments.

The petitioner and other *amici* herein have taken advantage of this Court's willingness to receive further briefing on the subject of the effect of the interpretive ruling to reargue the preemption question. The Comptroller believes that this subject has been adequately addressed in the previous rounds of briefing in this case, and will not use this brief as a vehicle to reargue that point. However, the Court should be advised here that the view of preemption set forth by the Comptroller both in his *amicus* briefs and in his interpretive ruling is squarely in accord wth the most recent court decisions on preemption in the banking area.

In *Fidelity Federal Savings & Loan Assn. v. de la Cuesta*, 458 U.S. 141 (1982), the Supreme Court found that the Federal Home Loan Bank Board's due-on-sale regulations preempted conflicting California state limitations on due-on-sale practices. While *de la Cuesta* was decided by the Court on the basis of an actual conflict between valid federal regulations and state law, the Court

was also instructive with respect to the question of Congress' occupation of a field, thereby superseding state law. The Court stated:

> The pre-emption doctrine, which has its roots in the Supremacy Clause, U.S. Const, Art VI, cl 2, requires us to examine congressional intent. Preemption may be either express or implied, and "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." Jones v Rath Packing Co., 430 US 519, 525, 51 L Ed 2d 604, 97 S Ct 1305 (1977). Absent explicit pre-emptive language, Congress' intent to supersede state law altogether may be inferred because "[t]he scheme of federal regulation may be so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it," because "the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject," or because "the object sought to be obtained by federal law and the character of obligations imposed by it may reveal the same purpose." Rice v. Santa Fe Elevator Corp. 331 US 218, 230, 91 L Ed 1447, 67 S Ct 1146 (1947).

458 U.S. at 152-153.

The Court in *de la Cuesta* thus recognized that a finding of Congressional occupation of a field is not dependent upon an explicit statement of Congress that it is superseding state law on a particular topic, but may be inferred from a pervasive scheme of federal statutory and regulatory action and from a clearly predominant federal interest in the field. Such federal preeminence is clearly present in the general field of regulation of the rates and charges of national banks, as well as in the specific field of service charges on deposit accounts. As demonstrated in the Comptroller's opening *amicus* brief in this cause,

such preemption may be inferred from the pervasive federal statutory and regulatory scheme governing national banks, as found in the National Bank Act, 12 U.S.C. §§ 21-215, together with the strong Congressional interest in the opening of deposit-related banking services to the free play of market forces, as evidenced by such recent legislation as the 1980 Depository Institutions Deregulation and Monetary Control Act, Pub. L. 96-221, 94 Stat. 132, and the 1982 Garn-St. Germain Act, Pub. L. 97-320. It is simply Constitutionally abhorrent for the states to attempt to reregulate, whether by statute or by judicial rate-making, what Congress has chosen to deregulate.

The *de la Cuesta* decision is significant for still another reason. The Court there struck down an attempt to use a state law principle of general application, the Wellenkamp doctrine, to regulate an area, when such regulation by judicial fiat conflicted with a clear federal interest. The Wellenkamp doctrine is simply the "unconscionability" premise of this case under a different name. It is submitted that, in light of the *de la Cuesta* ruling, such state law principles as have been propounded in this case must give way to the overriding federal interest in the area.

Appellant's attempt to distinguish *de la Cuesta* betrays specious reasoning. Appellant argues that since the Court in *de la Cuesta* based its finding of preemption on a broad delegation of power by Congress to the Federal Home Loan Bank Board, there can be no preemption here because there has been no delegation of power to federal agencies regarding the specific topic of service charges. Appellant's Reply Brief at 17-18. That argument is a *non-sequitur*; the broad delegation of power to the Bank Board bears no relation to a narrow delegation of power with respect to such a limited area as service charges. Indeed, appellant's argument might be somewhat comprehensible if the Supreme Court had found it necessary to find an explicit delegation on the subject of due-on-sale clauses, a subject more nearly akin to service charges.

But the Court found it sufficient for preemption purposes to find a general delegation of power to regulate thrifts to the Bank Board. Such a general delegation of power to regulate national banks has been given to the Comptroller, a broad power that encompasses even the limited area as service charges, just as the Bank's broad power encompasses such a limited area as due-on-sale.

Also of significance is the recent case of *Conference of State Bank Supervisors v. Conover*, 710 F.2d 878 (D.C. Cir.), decided June 30, 1983. In that case, the U.S. Court of Appeals for the District of Columbia found that the Comptroller's regulations on adjustable-rate mortgages preempted inconsistent state laws. The decision is significant for two reasons.[2] First, the court stated that the teachings of the *de la Cuesta* opinion were applicable to national banks, and were not limited only to savings and loan institutions. Secondly, and most importantly, the court stated:

> It bears repeating that the entire legislative scheme [on the powers of national banks] is one that contemplates the operation of state law only in the absence of federal law and where such state law does not conflict with the policies of the National Banking Act. So long as he does not authorize activities that run afoul of federal laws governing the activities of national banks, therefore, the Comptroller has the power to preempt inconsistent state law.

Id. at 885.

The court in that recent case, therefore, reaffirmed the preeminence of the federal legislative scheme in the regu-

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[2] Because this case turned on a conflict between state law and regulations of the Comptroller, and not the question of Congressional occupation of an area or the effect of an interpretive ruling, the Comptroller does not contend that this case is directly controlling here.

lation of national banks, and underscored the fact that state law shall not be allowed to intrude on that legislative scheme mandated by Congress.

III. The Interpretive Ruling Is Entitled to Due Deference as an Official Pronouncement of the Federal Regulator with Congressionally Mandated Authority for the Administration of the National Banking System.

The rule addressed by this brief, 12 C.F.R. § 7.8000 as amended, is by its very terms an interpretive rule. The significance for this Court of that fact may be discerned from the following statement by the U.S. Court of Appeals for the District of Columbia Circuit in *Guardian Federal Savings and Loan Assn. v. Federal Savings and Loan Ins. Corp.*, 589 F.2d 658 (1978):

> Although the term "interpretive rule" is not expressly defined by the [Administrative Procedure Act], its essential meaning is readily distinguished from that of a "substantive" or "legislative" rule. A substantive or legislative rule has the force of law; an interpretive rule is merely a clarification or explanation of an existing statute or rule. The Attorney General's Manual defines interpretive rules as "rules or statements issued by an agency to advise the public of the agency's construction of the statutes and rules which it administers." Judicial review of a substantive or legislative rule is limited by the provisions of APA section 706, but a court is free to make an independent inquiry into the correctness or propriety of an interpretive rule, although substantial deference is accorded to the agency's interpretation. . . .

Id. at 664-665 (footnotes omitted).

The Comptroller wishes to make clear to the Court that he does not propose that his interpretive rule be given the force of law; he does respectfully submit, however, that the rule should be accorded the substantial deference due his interpretation of the federal statutory scheme which it is his mandate to administer. And it is that statutory scheme, and not the ruling itself, that preempts state law.[3]

It is a longstanding principle that courts will give deference to statutory interpretations made by agencies with peculiar expertise in the area in question. This was first clearly enunciated by the Supreme Court in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). There the Court, first noting that it "has long given considerable and in some cases decisive weight" to agency interpretive regulations, stated that such interpretations, ". . . while not controlling on the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance." *Id.* at 140. In *Griggs v. Duke Power Co.*, 401 U.S. 424, 433-34 (1971), the Court reaffirmed that the administrative interpretation of a federal statute by the enforcing agency is entitled to great deference, especially when the statute and legislative history support the agency's construction. *See also Whirlpool Corp.* v. *Marshall*, 445 U.S. 1, 11 (1980) (Interpretive regulation entitled to deference unless it can be said not to be a reasoned and supportable interpretation of the underlying statute).

Appellant and other *amici* argue that the Comptroller's ruling does not find support in Congressional intent or

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[3] The Court should also understand that the Comptroller is not stating that this Court is without jurisdiction in this case, but rather that the Court cannot apply state law to questions involving the deposit-taking authority of national banks, since such state law has been preempted by Congressional action in this area.

legislative history, making much over the fact that members of the Comptroller's staff had, during the 1970's, issued opinions that purportedly run counter to the Comptroller's position in the interpretive ruling. Their point apparently is that, since the interpretive ruling is allegedly at odds with these opinion letters, the ruling is not entitled to deference by the Court.

This argument fails for three reasons. First, it is self-evident that in any conflict between an opinion letter by a staff member and a formal interpretive ruling promulgated by the Comptroller, the latter will be controlling. Second, the argument does not take into account the 1963 statement of then-Comptroller Saxon, discussed *supra* at p. 4, that indicates that the policy behind the interpretive ruling had been recognized over twenty years ago. Third, the argument ignores the fact that, since the time those opinion letters were issued, Congress has spoken in unequivocal terms in favor of the deregulation of the area of deposit-taking, through passage of such watershed legislation as the Depository Institutions Deregulation Act and the Garn-St. Germain Act. Prior to this deregulatory legislation, Congressional activity in the area of deposit-taking had largely been limited to the regulation of interest rates. By the same token, there has been no historic trend for states to interfere in banks' deposit-taking function, and consequently very few preemption cases have arisen in this area. Thus, even if there had been any doubt that Congress had occupied this area, this recently enacted statutory scheme, supplanting governmental rate-making with pricing by free market forces, should dispel those doubts. It is this clear Congressional deregulation of the area of deposit-taking by financial institutions that underlies the Comptroller's interpretive ruling.

In addition to the foregoing, the Court should consider the economic and regulatory context of the ruling. In recent years, as a result of a long and pervasive economic

recession, there have been a greater number of problem banks, a greater number of bank failures, and lower bank earnings than had been seen for many years. These institutions are now faced with the prospect of profits being squeezed by declining margins due largely to deregulated deposit rates. In partial response to this economic setting, the Comptroller has exhorted banks to develop an approach to fee income that would include offering new products and services and taking steps to eliminate the cross-subsidization of unprofitable products and services. Thus, by reason of the Comptroller's enunciated policy, fee income has become a much more significant factor in a bank's revenue base. The Comptroller's position that such fee income should depend upon market forces and not judicial rate-making is thus both reasonable and consistent when seen in context.

Finally, it has been argued that the interpretive ruling should be ignored because of procedural flaws in its promulgation, *i.e.*, that it was not subjected to a notice and comment period prior to adoption. That argument is misplaced.

The Administrative Procedure Act ("APA") has established certain notice and comment requirements that a federal agency must satisfy prior to the promulgation of a substantive regulation. 5 U.S.C. § 553. However, Congress in the APA expressly stated that agency activities other than the promulgation of substantive regulations need not comply with these notice and comment requirements. The issuance of an interpretive ruling is one agency activity expressly exempt from these statutory requirements. 5 U.S.C. § 553(b)(3)(A).

The Comptroller's ruling, as noted *supra* at p. 11, is by its own terms and by its intended operation an interpretive ruling and therefore within the exception to the notice and comment requirements of the APA. Appellant,

however, argues that this Court should view this interpretive ruling as an illegally promulgated substantive regulation. Appellant asserts that due to the "substantial effect" this interpretive ruling will have upon customers of national banks in California, it must be viewed as a substantive regulation and therefore subject to the APA notice and comment requirements.

In a recent decision, the U.S. Court of Appeals for the District of Columbia held that a substantial effect analysis is *not* the correct test for a court to apply when faced with the question of whether an agency action is an interpretive ruling or a substantive regulation. "Simply because agency action has substantial impact does not mean it is subject to notice and comment if it is otherwise expressly exempt under the APA." *Cabais v. Egger*, 690 F.2d 234, 237 (D.C. Cir. 1983). The court there reiterated that the proper test for resolving the substantive-interpretive dichotomy is found in *Gibson Wine Co. v. Snyder*, 194 F.2d 329, 331 (D.C. Cir. 1982):

> Generally speaking, it seems to be established that regulations, substantive rules, or legislative rules are those which create law, usually implementary to an existing law; whereas interpretive rules are statements as to what the administrative officer thinks the statute or regulation means.

Cabais v. Egger, 690 F.2d at 238 (quoting *Gibson Wine Company v. Snyder*).

Applying this test so recently reaffirmed by the D.C. Circuit, the Comptroller's ruling must be viewed as a validly adopted interpretive ruling. By promulgating this ruling the Comptroller does not purport to create law, but to state for broad application his position on what existing law demands.

Dated: January 27, 1984

Respectfully submitted,

COMPTROLLER OF THE CURRENCY
OF THE UNITED STATES

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[Appendix A, letter from John T. Simon, Comptroller of the Currency, dated November 4, 1983, and proof of service and service list omitted]

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA

Civil No. A013838

PAUL PERDUE,
Plaintiff and Appellant,

v.

CROCKER NATIONAL BANK,
Defendant and Respondent.

BRIEF OF AMICUS CURIAE COMPTROLLER OF THE CURRENCY

INTRODUCTION

The office of the Comptroller of the Currency (the "Comptroller"), a bureau of the United States Treasury Department, is the agency charged by Congress with the supervision and regulation of more than 4,500 national banks.[1] The Comptroller submits this brief as *amicus curiae* concerning federal policy in the area of free market competition for banks. When this case was before the California Court of Appeal the Comptroller filed an *amicus curiae* brief. For the reasons set forth in that brief and below, the Comptroller urges this Court to deny the present petition for hearing.

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[1] The Comptroller, *inter alia*, charters new banks, 12 U.S.C. § 27, examines banks, 12 U.S.C. § 481, approves branches, 12 U.S.C. § 36, and, when necessary, exercises enforcement authority, 12 U.S.C. § 1818.

ARGUMENT

The plaintiff in this case contends that, even assuming that the defendant bank has formed valid contracts under state law for the collection of NSF charges from its depositors, and conceding that these charges are fully disclosed to consumers and are in line with the market price for such charges generally, the state courts may under the doctrine of "unconscionability" inquire into the "reasonableness" of the charges in relation to the bank's "costs." If carried to this novel extreme, the doctrine of unconscionability is no longer solely a matter of state contract law, but instead becomes a question of regulatory policy affecting national banks, as to which the Federal government has a supervening policy interest. It is the Comptroller's position that *ad hoc* judicial inquiry into the reasonableness of the profit that a national bank earns in the course of its banking business is contrary to Federal policy that free marketplace competition should principally determine the level of pricing of a national bank's deposit-related charges.

Congress, by enacting the national banking laws, intended that national banks should be able to operate effectively in the competitive marketplace.[2] This Congressional intention, as reaffirmed by recent amendments to the national banking laws, sets forth a federal policy that national banks should be able to compete in the free marketplace without undue regulatory restraints.[3] Free market competition should be the principal determining

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[2] The antitrust laws ensure that competition exists in the marketplace. "Subject to narrow qualifications, it is surely the case that competition is our fundamental national policy . . . ." *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 372 (1963).

[3] Interpretive Ruling 8000 provides: All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, undertaking, understanding or even discussion among banks or their officers. 12 C.F.R. § 7.8000.

factor in the level of pricing by a national bank for its services, particularly where, as the Court of Appeals noted here, the charges are *fully disclosed. Perdue* v. *Crocker National Bank*, Civil No. 46808, slip op. at 11. Consequently, deposit-related charges, such as charges for checks returned NSF, should be determined by a national bank's assessment of the competitive marketplace and not by statutory or judicial direction.

Banking has been and continues to be a "highly regulated industry because of the unique role banks play in the economy." *Competition and Conditions in the Financial System, Hearings before the Senate Committee on Banking, Housing, and Urban Affairs*, 97th Cong., 1st Sess. 56 (1981) (hereinafter "*Competition and Conditions in the Financial System*") (Statement of Frederick H. Schultz, Vice Chairman, Board of Governors of the Federal Reserve System). Banks are regulated in the area of market entry and product and geographic diversification; under "prudential" regulations designed to insure the safety and soundness of financial institutions; in the area of reserve requirements and other restrictions related to the conduct of monetary policy; and in the area of consumer protection under legislation passed to insure important consumer rights, and to deal with the perceived inequities in the provision of financial services to women, minorities and low and moderate income individuals." *Id.* This extensive network of regulation, which represents Congress's balancing of the multiple interests and policies involved, affords meaningful and significant protection to consumers.

Over the past five years Congress has conducted an exhaustive inquiry into major banking laws and the competitive and financial condition of the nation's financial system.[4] A central finding of these hearings was

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[4] In addition to *Competition and Conditions in the Financial System, supra, see, e.g., The Consumer Checking Equity Act of 1979, Hearings before the Subcommittee on Financial Institutions Super-*

that while a considerable degree of regulation is necessary and appropriate, direct regulation of *price* within the financial system had produced waste and inefficiency, and that a competitive marketplace would produce a better allocation of products, services and prices to the ultimate benefit of consumers. These hearings resulted in the enactment of two omnibus banking statutes that reflect Congress's commitment to this principle.

In 1980, Congress enacted the Depository Institutions Deregulation and Monetary Control Act, Pub. L. 96-221, 94 Stat. 132 ("1980 Act"). The 1980 Act, *inter alia*, authorized banks and federal savings and loan associations to offer interest bearing checking accounts (commonly known as NOW accounts), and provided for the phasing-out of interest-rate ceilings on savings and time deposits by 1986, under the guidance of the newly created Depository Institutions Deregulation Committee (DIDC). A principal purpose of the 1980 Act was to promote competitive equality among depository institutions and enable them to compete with other financial service providers on the basis of price. S. Rep. 368, 96th Cong., 2d Sess. 6, *reprinted in* 1980 U.S. Code Cong. & Ad. News 241. Commenting on the impact of the 1980 legislation, Vice Chairman Frederick H. Schultz of the Board of Governors of the Federal Reserve System testified:

> The [1980 Act] has radically changed the possibility for "regulation" through the pressures of a competitive marketplace, rather than governmental action. The number of institutions offering bank-

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vision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, 96th Cong., 1st Sess. (1979); *Financial Institutions in a Revolutionary Era: Hearings before the House Committee on Banking, Finance and Urban Affairs*, 97th Cong., 1st Sess. (1981); *Financial Institutions Restructuring and Services Act of 1981, Hearings on S. 1686, S. 1703, S. 1720 and S. 1721 before the Senate Committee on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. (1981).

> like services to consumers has been increased by the legislation from about 14,000 to about 40,000.
>
> * * * *
>
> Competition to attract deposits, to make loans, and to provide other financial products will encourage the provision of services and information that many bank customers need and are willing to pay for.

Competition and Conditions in the Financial System, *supra*, at 55.

In enacting the 1980 Act, Congress recognized that "[t]ransition to a more competitive climate is always painful" but put "all institutions on notice that change is inevitable—that savers are eventually going to realize a market rate of return and that plans must be made today for competing in the future." S. Rep. No. 368, 96th Cong., 2d Sess. 5, *reprinted in* 1980 U.S. Code Cong. & Ad. News 240. It was also recognized that the transition had profound implications for the safety and soundness of depository institutions,[5] and must proceed with a minimum of disruption:

> [T]echnology, inflation, and the volatility of the marketplace have assured deregulation. The task before us is to provide deposit-taking institutions the capacity to compete and serve the public effectively *while minimizing the potentially disruptive consequences of dramatic change.*

Competition and Conditions in the Financial System, *supra*, at 64 (Remarks of John G. Heimann, Comptroller of the Currency of the United States) (emphasis added).

In 1982 Congress reaffirmed and extended its commitment to deregulation in favor of free market competi-

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[5] Accordingly, DIDC was directed to phase out interest rate controls "as rapidly as economic conditions warrant" without exceeding market rates, and with due regard for the "safety and soundness of depository institutions." 1980 Act at § 204, 12 U.S.C. § 3503.

tion for national banks and other financial institutions in the Garn-Saint Germain Act, (the "1982 Act").[6] The 1982 Act, *inter alia*, amended national banking laws in the areas of lending limits, real estate lending and bank borrowing to "allow banks to respond better to changing economic curcumstances and new marketplace competitors," S. Rep. No. 536, 97th Cong., 2d Sess. 25 (1982).[7]

Congress liberalized the lending limit provisions of 12 U.S.C. § 84 to allow banks to be more effective in the competitive marketplace.

> Generally, this amendment is intended to provide smaller national banks with the ability to meet local credit needs *and to compete with less restricted banks and non-bank competitors.* (emphasis added)

Id. at 26. Similarly, Congress simplified the real estate lending authority of national banks to:

> provide national banks with the ability to engage in more creative and flexible financing, *and to become stronger participants in the home financing market.* (emphasis added)

Id. at 27. In addition, Congress removed regulatory constraints on national bank borrowings to provide banks with

> greater flexibility to fund their activity through modern techniques *and to compete more effectively with state chartered banks and less regulated institutions.* (emphasis added)

Id. The 1982 Act also directed DIDC to develop and make available to all financial institutions a new market

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[6] Depository Institutions Amendments of 1982, P.L. 97-320.

[7] *See also Competition and Conditions in the Financial System, supra*, at 31 (1981) (Remarks of Donald T. Regan, Secretary of the Treasury).

rate deposit account that is directly equivalent to and competitive with money market mutual funds. 1982 Act at § 327, 12 U.S.C. § 3593(c)(1). It is apparent that the ability of a national bank to compete effectively in the free marketplace is a clear Congressional objective in both the 1980 and 1982 Acts.

It is also apparent, both in the extensive legislative history on both Acts [8] and as a matter of logic, that the removal of artificial interest rate limitations—*i.e.*, limits on the amount that banks can *pay* for deposits—would also affect the prices that they *charge* for their services. It was, however, the conclusion of Congress and the regulatory agencies charged with overseeing banking policy that deregulation and increased competition among providers of deposit-related services can only redound to the ultimate benefit of the consumers of those services. As early as 1977, the Senate Committee on Banking, Housing and Urban Affairs stated in the context of hearings on interest bearing demand deposit accounts that if all financial institutions were authorized to offer such accounts, "*competition for consumer deposits will be active, and should result in improved quality and variety of consumer financial services.*" S. Rep. No. 407, 95th Cong., 1st Sess. 8 (1977).

These sentiments are echoed and amplified in the recent Senate Hearings:

> Competition to attract deposits, to make loans, and to provide other financial products will encourage the provision of services and information that customers need and are willing to pay for. Competition will not insure perfect results, as measured against some ideal, but neither does regulation. *Competition, itself, may offer results that are acceptable when measured against the cost and imperfect success of governmentally regulated behavior, particularly when*

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[8] *See* footnote 4, *supra.*

> *the benefits of freedom-induced innovation over time are taken into account.*

Competition and Conditions in the Financial System, *supra*, at 55 (Remarks of Frederick H. Schultz, Vice Chairman, Board of Governors of the Federal Reserve System) (emphasis added). At another point, Donald T. Regan, Secretary of the Treasury, stated that: "The ultimate beneficiary of [deregulation] would be the consumer or other user of depository institution services whose special conveniences could be more readily addressed." *Id.* at 33. *See also Competition and Conditions in the Financial System*, *supra*, at 65 ("our present framework is increasingly out of touch with the market realities. Whatever reform occurs elsewhere, the failure to address this issue will assure increasingly inefficient and costly regulation.") (Statement of John G. Heimann, Comptroller of the Currency.)

To impose an artificial limitation on a national bank's deposit-related charges, including NSF service charges, in the face of federally mandated deregulation of interest rate ceilings is not only inconsistent with the federal policy favoring free market competition, but also represents a serious threat to the safety and soundness of national banks.

If national banks are to be able to compete effectively and survive in this deregulated environment, they must be free to set their prices "on a competitive basis," 12 C.F.R. § 7.8000, consistent with sound business judgment, without the interference of *ad hoc* judicial determinations of "reasonableness" under the rubric of "unconscionability."

CONCLUSION

The petition for hearing in this case asks this Court to determine regulatory policy affecting national banks, contrary to the federal policy that free marketplace competition should determine the level of pricing of a national bank's services. Because a hearing in this case would necessarily and inappropriately involve this Court in issues of national bank regulatory policy, the Comptroller urges this Court to deny appellant's petition for a hearing and allow the decision reached in the Court of Appeals to stand.

Respectfully submitted,

Dated: June 20, 1983

COMPTROLLER OF THE CURRENCY
OF THE UNITED STATES

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[Proof of service and service list omitted]

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No. 85-1035

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal From the Supreme Court of California

MOTION TO DISMISS OR TO AFFIRM

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QUESTIONS PRESENTED

1. Is the judgment of the California Supreme Court "final" within 28 U.S.C. § 1257, where California has not decided whether appellant's service charges violate state law, and where there is no important federal policy which would be seriously eroded by deferring review until that question has been decided?

2. Does the National Bank Act and related federal law preclude California from applying its unconscionability statute to national banks that impose unconscionable charges for overdrawn checks?

TABLE OF CONTENTS

Page

JURISDICTION 1

STATEMENT 1

THE APPEAL SHOULD BE DISMISSED OR THE JUDGMENT AFFIRMED 4

A. The Questions Presented Are Not Substantial 5

1. *The National Bank Act* 5

2. *The Comptroller's Interpretative Rule* 12

3. *The 1980 and 1982 Statutes* 13

B. This Court Has No Jurisdiction To Hear This Appeal 15

CONCLUSION 17

TABLE OF AUTHORITIES

Cases: Page

Anderson National Bank v. Luckett,
321 U.S. 233 (1944) 11, 12

Capital Cities, Inc. v. Crisp,
467 U.S. ____, 104 S.Ct. 2694 ..... 9, 10

Cox Broadcasting Corp. v. Cohn,
420 U.S. 469 (1975) 15, 16

Duke Power Co. v. Carolina Environmental Study Group, 438 U.S. 59 (1978) 14

Fidelity Federal Savings & Loan Association v. De la Cuesta, 458 U.S. 141 (1982) 6, 13

First National Bank v. Kentucky,
76 U.S. 353 (1870) 3, 10

First National Bank v. Missouri,
263 U.S. 640 (1924) 4, 7, 10-11

Franklin National Bank v. New York,
347 U.S. 373 (1954) 8-9

Jacklich v. Baer,
57 Cal.App.2d 684, 135 P.2d 179 (3rd DCA 1943) 16

Jacobs v. Citibank,
61 N.Y.2d 689, 462 N.E.2d 1182 (1984) 9

McClellan v. Chipman,
164 U.S. 347 (1896) 10

Pacific Gas & Electric v. State Energy Resources Conservation & Development Comm.,
461 U.S. 190 (1983) 9

Silkwood v. Kerr-McGee Corp.,
464 U.S. 238 (1984) 5, 9

Page

Skidmore v. Swift & Co.,
323 U.S. 134 (1944) 13

United States Trust Co. of New York v. New Jersey,
431 U.S. 1 (1977) 15

United States v. Security Industrial Bank,
459 U.S. 70 (1982) 14

Waite v. Dowley,
94 U.S. 527 (1877) 10

Statutes and Regulations:

Administrative Procedure Act,
5 U.S.C. § 553 ..... 3, 12

California Civil Code § 1670.5 ..... *passim*

California Financial Code

Sections 99-3707 11
Section 865.4(b)(1) 11

Depository Institutions Deregulation and Monetary
Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 13

Garn-St. Germain Depository Institutions Act of 1982,
Pub. L. No. 97-320, 96 Stat. 1469 13

12 C.F.R.

Section 7. 6025(a) (1985) 7
Section 7.800 (1985) 12

Page

12 U.S.C.

Section 24 ..... 5, 11
Section 36 6
Section 85 6
Section 484 ..... 5, 7
Section 1735f-7 14
Section 1832(a) 14
Section 1842(d) 6
Section 3503 14

28 U.S.C. § 1257 ..... 1, 15

Other Authorities:

Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 Stan. L. Rev. 1 (1977) 11

Senate Report No. 96-368, 96th Cong. 2nd Sess. (1979) 13, 14

48 Fed. Reg. 54319 (1983) 13

49 Fed. Reg. 28237 (1984) 13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1035

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal From the Supreme Court of California

MOTION TO DISMISS OR TO AFFIRM

JURISDICTION

Appellant seeks review under 28 U.S.C. §§ 1257(2) and 1257(3). However, as explained more fully at pages 15-17, *infra*, the California Supreme Court has not issued a "final judgment" within 28 U.S.C. § 1257, and this case does not fall within one of the recognized exceptions to the final judgment rule. Therefore, this Court should dismiss the appeal.

STATEMENT

In 1976, appellee Paul Perdue opened a checking account at the appellant Crocker National Bank ("Crocker").[1] At that time, Perdue executed a bank signature card that re-

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[1] "App.__" refers to one of the appendices to the Jurisdictional Statement; "Add.__" refers to the addendum to this brief; "JS__" refers to Crocker's Jurisdictional Statement; "Opinion" refers to the opinion of the California Supreme Court.

quired him to pay whatever service charges Crocker chose to impose (Opinion, App. A at 13a). Subsequently, one of his checks was returned for insufficient funds (an "NSF" check), and Crocker imposed a $6 service charge. Thereafter, on July 3, 1978, Perdue filed a class action lawsuit against appellant seeking damages for himself and other Crocker customers who were similarly injured. His complaint alleged that if the signature card is a contract, it is a contract of adhesion, and that Crocker's fee for NSF checks is unconscionable (App. D at 58a-60a). The critical factual allegation was that NSF checks cost defendant $.30, whereas Crocker charged customers $6, or 20 times the actual cost (App. D at 57a).

The trial court dismissed the complaint for failure to state a claim upon which relief may be granted (App. B at 38a), and the California court of appeals affirmed (App. C at 40a). Neither court relied on the National Bank Act, 12 U.S.C. §§ 1, *et seq.*, and the preemption issue, which is the basis for this appeal, was not raised until the Comptroller of the Currency (the "Comptroller") filed an *amicus curiae* brief shortly before oral argument in the court of appeals.

The California Supreme Court reversed, holding that the trial court had erred on the question of whether plaintiff had stated a cause of action for unconscionability (App. A at 37a). Relying on California Civil Code § 1670.5 (App. K at 103a), which is applicable to all businesses in the State, the Court held that appellee is entitled to a hearing on whether the NSF charge of $6 imposed by Crocker is unconscionable (App. A at 14a). In support of this conclusion, the Court pointed out that the "contractual language appears in print so small that many could not read it," and that the signature card does not identify the amount of the charges for NSF checks or even the fact that the consumer is agreeing to pay for them (*id.* at 3a, 13a). Instead, it simply states that the depositors "agree with Crocker National Bank [that] this account and all deposits therein shall be . . . subject to all ap-

plicable laws, to the Bank's present and future rules, regulations, practices and charges" (*id.* at 2a).[2]

Furthermore, the bank does not provide depositors with a schedule of its charges, and it retains the power to change its fees at any time, although pursuant to California law it must give customers notice of such changes (*id.* at 3a). "In short," according to the Court, "the bank structured a totally one-sided transaction" (*id.* at 14a). Given the "absence of equality of bargaining power," the Court held that "plaintiff's charge that the bank's NSF fee is exorbitant. . . cannot be dismissed on demurrer" (*id.* at 14a).

The Court then considered the question of whether the National Bank Act or any other federal banking legislation preempts the state statute prohibiting unconscionable contracts. In evaluating this question, it considered a regulation adopted by the Comptroller just two business days before oral argument, which the Comptroller conceded was merely interpretative because it had not been adopted in compliance with the notice and comment requirements of the Administrative Procedure Act, 5 U.S.C. § 553. After reviewing the statutes, regulations, and case law, the Court rejected the Comptroller's interpretation and held that Congress had not preempted this state law. In support of this conclusion, it pointed out that there is no language in the applicable statutes indicating an intent to preempt state law and that this Court has recognized in a long line of cases that "national banks have traditionally been 'governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws.' " *Id.* at 27a, *quoting First National Bank v. Kentucky*, 76 U.S. 353, 362 (1870). Accordingly, the California Supreme Court reversed the judgment below and remanded the case to the trial court for resolution of the request for class certification and the merits (*id.* at 37a).

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[2] The full contractual provision which appears on the signature card is set out in its actual type-size below:

> We agree with Crocker National Bank and each other that
> This account and all deposits therein shall be of the kind and nature indicated above, and subject to all applicable laws, to the Bank's present and future rules, regulations, practices, and charges, and to its right of setoff for the obligations of any of us.

Complaint, Exhibit 2 (re-typeset for clarity).

THE APPEAL SHOULD BE DISMISSED OR THE JUDGMENT AFFIRMED.

On several occasions, this Court has held that the states have the authority to regulate national banks unless there is a direct conflict between state and federal law. *See First National Bank v. Missouri,* 263 U.S. 640 (1924) and cases cited at pp. 10-11, *infra.* As demonstrated in section A below, the California Supreme Court correctly interpreted these cases and this Court's recent decisions concerning the federal preemption doctrine. Thus, federal banking statutes have not preempted California's prohibition on unconscionable contracts because there is no conflict between state and federal law and because Congress has not occupied the field of banking. Indeed, the Comptroller himself has periodically issued opinions which conclude that states have the power to regulate service charges imposed by national banks, and thus the California Supreme Court correctly rejected the Comptroller's contrary 1983 interpretative ruling.

Although jurisdictional questions are ordinarily discussed before the merits, here the jurisdictional issue is intertwined with the merits because it involves principally an issue of timing and depends in part on the nature of appellee's claim and Crocker's defenses. Therefore, we discuss the jurisdictional issue in section B, where we demonstrate that even if this case raised substantial questions of federal preemption, it will not be suitable for review until the California courts have decided whether the particular service charges at issue are unconscionable. Only then will it be possible to determine the extent to which California's contract law interferes with national banking policy, which is the critical issue that the Court would have to decide if it granted plenary review at this time. Since the decision below does not fall within any of the recognized exceptions to the final judgment rule, the appeal should be dismissed for want of jurisdiction.

A. The Questions Presented Are Not Substantial.

This Court held in *Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238 (1984), that Congress may preempt state laws in one of two ways. First, a state law is preempted "to the extent it actually conflicts with federal law, that is, when it is impossible to comply with both state and federal law" or "where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." 464 U.S. at 248. Second, "[i]f Congress evidences an intent to occupy a given field, any state law falling within that field is preempted." *Id.* While it is not clear from Crocker's Jurisdictional Statement on which of these doctrines its argument depends, an examination of the relevant federal banking laws and regulations demonstrates that Congress has not preempted state laws pertaining to bank service charges under either approach.

1. The National Bank Act.

a. The authority on which Crocker principally relies is the National Bank Act of 1864. However, that statute does not mention bank service charges, but instead authorizes the Comptroller to charter national banks and defines the powers of those banks. Nevertheless, Crocker contends that two provisions support its preemption argument: the general powers conferred by section 24 and the limitation on visitorial powers in section 484. 12 U.S.C. §§ 24, 484.

There is no conflict between the seventh power in section 24 and state law since the bank can easily comply with both California law and the National Bank Act. California Civil Code 1670.5 provides that a court may "limit the application of any unconscionable clause [in a contract] as to avoid any unconscionable result" as well as impose various other remedies which are traditional for breach of contract claims. No provision of federal law requires that banks impose unconscionable fees, and in fact, the seventh power, cited by Crocker (JS 8), simply provides that national banks shall have "all such incidental powers as may be necessary to carry on the business of banking." 12 U.S.C. § 24. Thus, on its face, this provision of the

National Bank Act does not conflict with California Civil Code § 1670.5.

Section 24 of the National Bank Act contrasts sharply with the three examples of provisions that preempt state law which are cited in the *amicus curiae* brief of the California Bankers Clearing House Association ("California Bankers"): 12 U.S.C. § 36 (regulating the use of branch banks); § 85 (regulating interest charges); and § 1842(d) (regulating the acquisition of bank holding companies). In each instance, Congress explicitly regulated an area of banking and preempted state law, although it also provided that states may regulate to a limited degree. Since Congress preempted the states in these three areas, the fact that it explicitly left the states some authority to regulate does not demonstrate, as the California Bankers argue (Br. 6-9, 12), that Congress's failure to authorize state regulation of service charges indicates an intent to preempt this area as well. To the contrary, the existence of these specific preemption provisions and the absence of a comparable provision applicable to service charges demonstrate that Congress intended that state contract law apply to bank service charges.[3]

Nor has Crocker or the *amici curiae* identified a fundamental purpose or objective in the National Bank Act which would be frustrated by the application of California's unconscionability law to national banks. California has not impaired the ability of national banks to operate within the State or discriminated against national banks in any way. It has merely prohibited all businesses, including national banks, from treating customers in

[3] The California Bankers' reliance on *Fidelity Federal Savings & Loan Association v. De la Cuesta*, 458 U.S. 141, 163 (1982) (Br. 8) is also misplaced. The question in *De la Cuesta* was whether the failure of Congress to preempt the states from regulating the terms of home mortgage loans issued by national banks had the effect of prohibiting the Federal Home Loan Bank Board from issuing a regulation, after providing notice and an opportunity to comment, which preempted contrary state laws. Since the Comptroller has not issued a substantive regulation preempting the states in the area of service charges, *see* pp. 12-13, *infra*, the *De la Cuesta* case simply has no application to the issues raised here. If anything, the case is supportive of appellee since the Court appeared to assume that state law would have applied if the Federal Home Loan Bank Board had not issued its own substantive regulation.

a grossly unfair manner. Since national banks are otherwise free to conduct their business, there is no conflict between the state law and the purposes of the National Bank Act.

There is also no inconsistency between section 484 of the National Bank Act and California law. That section states that "[n]o national bank shall be subject to any visitorial powers except as authorized by Federal law, [or] vested in the courts of justice. . . ." 12 U.S.C. § 484. Although the Comptroller did not rely on section 484 in either of the briefs he filed in the California Supreme Court or in the preamble to his interpretative regulation (App. L at 104a-27a), Crocker argues that the states have no authority to prohibit unconscionable contracts because section 484 gives only the Comptroller access to the records of a national bank. *See* JS 14. This contention is similar to an argument advanced in *First National Bank v. Missouri, supra,* where this Court held that states may prohibit national banks from establishing branch offices. There, the Court found that "the United States alone may inquire by quo warranto whether a national bank is acting in excess of its charter powers, and that the state is wholly without authority to do so," but it nevertheless concluded that the National Bank Act was no bar to the enforcement of state law. 263 U.S. at 660. Similarly here, any prohibition in section 484 of the Act is no bar to the enforcement of California's unconscionability statute.

The California Supreme Court suggested that section 484 may limit the appellee's discovery and thus may make it more difficult for Perdue to prove his case at trial (App. A at 21a n.21). However, this possibility does not amount to a conflict between the federal and state statutes since Crocker can easily comply with section 484 and California Code § 1670.5, and since the purpose served by section 484 is not frustrated by the State's unconscionability law.[4]

[4] There is also a serious question as to the correctness of Crocker's claim that appellee may not use the judicial process to determine the basis for Crocker's NSF charges. Section 484 authorizes the Comptroller to create exceptions to the prohibition on examining bank records, which he has done by specifically providing that "[p]roduction of records may, however, be required under normal judicial procedures." 12 C.F.R. § 7.6025(a) (1985). This regulation is consistent with 12 U.S.C. § 484, which also creates an exception for "courts of justice."

Nor is there any conflict between the Comptroller's *Handbook*, which mentions that NSF charges should be sufficiently high to deter NSF checks (App. J at 91a), and the California unconscionability law. First, the Comptroller's *Handbook* is not a duly promulgated regulation and therefore is relevant only to the extent that it correctly interprets the National Bank Act. Second, the unconscionability doctrine prohibits only unreasonable charges, and Crocker will have the opportunity to prove at trial that its charges serve a legitimate business purpose and that its fees have been endorsed by the Comptroller. Even if the California court were to conclude that its fees are unconscionable, Crocker has not demonstrated, and presumably could not demonstrate, that it would be deprived of the ability to charge fees sufficiently high to deter NSF checks.

The only case which Crocker has identified where this Court has held that there is a conflict between federal banking law and state law is *Franklin National Bank v. New York*, 347 U.S. 373 (1954). There, this Court reviewed a New York law that permitted state-chartered savings banks to advertise that they accepted savings accounts, but prohibited all other banks, including national banks, from using the words "saving" or "savings" in their advertising or business. This Court held that the New York law conflicted directly with the National Bank Act and the Federal Reserve Act, which both specifically authorized national banks to receive savings deposits. 347 U.S. at 377-78. Relying on "the fact that Congress has given a particular label to this type of account," the Court reasoned that "[i]t would require some affirmative indication to justify an interpretation that would permit a national bank to engage in a business but gave no right to let the public know about it." *Id.* Moreover, that statute discriminated against national banks since it permitted state but not federal banks to advertise that they would accept savings deposits. Here, none of these factors exist: there is no provision in federal law covering such service charges; a prohibition on exorbitant service charges will not interfere with Crocker's ability to conduct the business of banking; and the California statute applies equally to state and national banks, as

well as to all other California businesses. Thus, *Frankin National Bank* does not support the Comptroller's argument that the National Bank Act is inconsistent with California's unconscionability law.[5]

b. It is equally clear that Congress did not intend to occupy the entire field – that is, to preempt all state laws applicable to national banks. Although there have been numerous cases litigated under the National Bank Act during the past 120 years, insofar as we are aware, no court has ever held that the Act entirely preempts the states from regulating national banks.

In recent years, this Court has considered this general issue on several other occasions, and it has uniformly required an affirmative showing that Congress or the administrative agency intended to preempt the entire field before it has concluded that state law has been rendered inoperative. For example, in *Pacific Gas & Electric v. State Energy Resources Conservation & Development Comm.*, 461 U.S. 190 (1983), the Court held that states may prohibit the construction of nuclear reactors for reasons not related to safety, even though Congress and the Nuclear Regulatory Commission had preempted the entire field of nuclear safety through the comprehensive and detailed regulation of commercial nuclear power plants. Similarly, in *Silkwood v. Kerr-McGee Corp., supra*, victims of radiation injury were allowed to recover punitive damages from nuclear power companies, even though one of the purposes of punitive damages is to deter the unsafe operation of nuclear power plants. The decision in *Capital Cities, Inc. v. Crisp*, 467 U.S.

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[5] Crocker also asserts that *Jacobs v. Citibank*, 61 N.Y.2d 689, 462 N.E.2d 1182 (1984), supports its preemption argument. However, the principal basis for the decision in *Jacobs*, which was decided without a trial, was that the service charges at issue there were not unconscionable under New York law. 462 N.E.2d at 1184. While the Court noted that the task of limiting service charges imposed by national banks "is a task more properly left to the Comptroller of the [C]urrency," 462 N.E.2d at 1183, the opinion contains no discussion of federal preemption. Thus, Crocker's statement that "the decision below squarely conflicts with the decision in [*Jacobs*]" (JS 23) is incorrect.

____, 104 S.Ct. 2694 (1984), is also consistent with these precedents. There, this Court ruled that the Federal Communication Commission's intent to preclude state regulation of cable television advertising, unambiguously expressed in regulations over a 20-year period, preempted a state law prohibiting advertising of alcoholic beverages, especially where the Oklahoma law "forces [cable] operators to lose the protections of compulsory licensing." 104 S.Ct. at 2707.

Here, in contrast, this Court has explicitly recognized on several occasions that national banks are regulated by both federal and state laws. As it held shortly after the National Bank Act was enacted,

> [w]e have more than once held in this Court that the national banks organized under the Acts of Congress are subject to state legislation, except where such legislation is in conflict with some Act of Congress, or where it tends to impair or destroy the utility of such banks, as agents or instruments of the United States, or interfere with the purposes of their creation.

Waite v. Dowley, 94 U.S. 527, 533 (1877). The Court had articulated this principle in *First National Bank v. Kentucky*, 76 U.S. 353, 362 (1870), ruling that states may tax stock in national banks, and cautioning that national banks "*are governed in their daily course of business far more by the laws of the State than of the Nation*" (emphasis supplied). It applied this principle again in *McClellan v. Chipman*, 164 U.S. 347 (1896), where it upheld a state law which had the effect of denying a national bank collateral on a loan.

The principles announced in these cases were followed in *First National Bank v. Missouri, supra,* in which the Court rejected a claim that a state law prohibiting banks from establishing branches was preempted by the incidental power provision in the National Bank Act relied on by Crocker here. 263 U.S. at 659. Although the authority to establish branch banks is far closer to the core of bank functions than is control over bank service charges, this Court emphasized that "national banks are [in general] subject to the laws of a state in respect to

their affairs." *Id.* at 656. The only limitation is that state laws must not "interfere with the purposes of their creation, tend to impair or destroy their efficiency as Federal agencies, or conflict with the paramount law of the United States" (*id.*), which, as shown above, is not the case here.

The Court followed these cases again in *Anderson National Bank v. Luckett*, 321 U.S. 233 (1944), where a national bank challenged a state law which required it to turn abandoned deposits over to the state. Although the National Bank Act specifically authorizes national banks to "receiv[e] deposits," 12 U.S.C. § 24, and although the Comptroller argued that state law was preempted, this Court upheld the state law. Again the Court emphasized that "national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions." 321 U.S. at 248.

The consistent theme which runs through all these cases is that the National Bank Act contemplates that the states are to have an important role in regulating the activities of national banks. All their contracts are governed by state law, as are numerous other aspects of their business. *See* Opinion at App. A, 29a n.33; *see also* California Financial Code §§ 99-3707. In fact, in its Jurisdictional Statement, Crocker acknowledges that California Financial Code § 865.4(b)(1) requires it to give customers 15 days notice of any change in its service charges (JS 5 n.4). Since Crocker apparently does not contend that this law is preempted, it implicitly agrees that the State may, to some extent, regulate the service charges imposed by national banks. *See also* Scott, *The Dual Banking System: A Model of Competition in Regulation*, 30 Stan. L. Rev. 1 (1977).

When these principles are applied to the instant case, it becomes evident that there is no substantial question as to whether the National Bank Act preempts California's law providing a remedy against unconscionable contracts. California Civil Code § 1670.5 does not interfere with Crocker's ability to carry out its function as a bank, nor does it conflict with a federal law. It applies equally to all businesses, including all

banks located in the State. Like the provision requiring notice of increases in service charges, section 1670.5 is intended to give customers a small amount of protection, while giving businesses, including banks, broad latitude to set prices and to conduct their affairs, as long as they do not act in an unconscionable manner.

2. The Comptroller's Interpretative Rule.

In 1977, the Comptroller issued an opinion letter which considered whether the National Bank Act or the Comptroller's regulations preempt state laws regulating bank service charges (Add. 1a-3a). Relying on *Anderson National Bank v. Luckett, supra*, and several other authorities, the Comptroller concluded that "[s]tate-imposed limitations on certain service charges would not seem to be subject to federal preemption under the criteria established in the case law." The letter also specified that service charges "should be arrived at by each bank on a competitive basis" and not jointly by the banks, and that "[a] state law or regulation which established a maximum amount for any particular type of service charge would . . .not be in conflict with the Comptroller's ruling." *Id.* The Comptroller reaffirmed his opinion in 1979 (Add 4a). *See also* Add. 5a.

Crocker relies on the recent contrary interpretative ruling, adopted by the Comptroller immediately before oral argument in the California Supreme Court, without notice and an opportunity for comment from the public. 12 C.F.R. § 7.800 (1985). Either the regulation was adopted to assist Crocker in this lawsuit, or there is a remarkable coincidence between its timing and this case. In either event, that regulation is not a substantive rule because it was not adopted in compliance with the requirements of the Administrative Procedure Act, 5 U.S.C. § 553. When appellee pointed this out to the California Supreme Court, the Comptroller agreed (App. L at 114a), and he subsequently amended the notice of the regulation to make it clear that the rule only provides the Comptroller's interpretation of

federal banking law. *Compare* 48 Fed. Reg. 54319 (1983) *with* 49 Fed. Reg. 28237 (1984) (App. I at 76a-86a).[6]

The Comptroller's interpretative rule, however, is entitled to little, if any, weight in deciding the statutory preemption issue here. As this Court emphasized in *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944), the value of an interpretative regulation in a particular case "will depend on the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." Here the Comptroller's notice of the new interpretation contains little discussion of the preemption question, and the rule itself is inconsistent with prior pronouncements. Moreover, its timing suggests that it was issued solely to influence the outcome of this case. Thus, applying the teachings of *Skidmore*, the California Supreme Court correctly concluded that the interpretative rule is in fact an attempt to legislate and held that "legislation cannot be enacted in the guise of statutory interpretation" (App. A at 33a).

3. The 1980 and 1982 Statutes.

The banking legislation adopted by Congress in 1980 and 1982 also does not bar appellee's claims.[7] Like the National Bank Act, neither statute refers to bank service charges. Moreover, the legislative history of the 1980 legislation demonstrates that Congress intended that all state laws pertaining to banking continue to apply to national banks, unless specifically preempted.

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[6] Thus, this case does not present the issue of whether the Comptroller would have the power to issue such a rule in compliance with the Administrative Procedure Act. In contrast to the authority given the Federal Home Loan Bank Board, *see Fidelity Federal Savings & Loan Association v. De la Cuesta*, *supra* (*see also* p. 6 n.3, *supra*), the Comptroller's rulemaking authority here is limited to regulating "unsafe and unsound banking practices." Senate Rep. No 96-368, 96th Cong., 2nd Sess. 13 (1979).

[7] *See* Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469; The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132.

Thus, the 1980 Act phased out regulation of interest rates paid by national and certain other banks, authorized federal institutions to offer interest-bearing checking accounts, and preempted state ceilings on mortgage interest. 12 U.S.C. §§ 3503, 1832(a), 1735f-7. Regardless of whether appellant is correct in its claim that Congress recognized that banks which paid consumers higher interest rates were likely to increase their service charges (JS 20), Crocker has been unable to identify any provision in the statute or any statement in its legislative history that even suggests that Congress intended to preempt all state laws applicable to bank service charges.

The issue of preemption was in fact discussed in the Senate Report in connection with the provisions preempting state usury limitations on mortgages. The Report explicitly states that the law was not intended to nullify state limitations on other payments associated with mortgage loans, such as pre-payment charges and attorney fees. Senate Report No. 96-368, 96th Cong. 2nd Sess. 19 (1979). The fact that Congress carefully limited the preemptive effect of even this law demonstrates that it could not have intended to preempt all state regulation of bank charges, as Crocker argues.

Even if the 1980 and 1982 bank deregulation acts had preempted state laws regarding bank service charges, those statutes would have no application here because appellee filed his complaint in July 1978. "The presumption is very strong that a statute was not meant to act retrospectively, and it ought never to receive such a construction if it is susceptible of any other." *United States v. Security Industrial Bank*, 459 U.S. 70, 79-80 (1982). Since there is not even a suggestion that Congress intended that the recent banking statutes be applied retroactively to cut off appellee's claim for damages, even if Crocker were correct about their impact on state laws regulating bank service charges, they have no application to this case. Moreover, construing the deregulation statutes retroactively to cut off these claims would raise serious constitutional issues. *Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59 (1978) (leaving open the question as to whether the due process clause

rohibits the elimination of state law claims without a easonable substitute); *cf. United States Trust Co. of New York. v. Jew Jersey,* 431 U.S. 1 (1977) (determination of whether state aw impairing contracts violated contract clause in U.S. Constitution turns on overall reasonableness of state's actions). For hese reasons as well, the 1980 and 1982 bank deregulation acts lo not preempt the state law applicable here.

* * * * *

Two other points are worth noting. First, although the decision below could apply to other bank service charges, there has been no claim that Crocker's other service charges are also unconscionable. Crocker will have the opportunity to argue to the trial court that the reasonableness of its other fees is relevant to the issue of whether its NSF charges are unconscionable. Second, the result that Crocker is advocating is one of no regulation since the Comptroller has not placed any limitation on service charges imposed by national banks. Thus, if California contract law does not apply, then Crocker and other banks could charge their customers any amount, even $100, for NSF checks. The fact that the Comptroller has chosen not to place any limit on these charges makes it even more important that the state unconscionability laws continue to apply to national banks.

B. This Court Has No Jurisdiction To Hear This Appeal.

Even if the Jurisdictional Statement raised a substantial federal question, the appeal should nevertheless be dismissed. Section 1257 of title 28 limits this Court's review of state court decisions to "final judgments." This Court has, with four exceptions, interpreted the final judgment rule to require that there be nothing further to be determined by the state court. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 477 (1975). Here, the state courts have not yet determined whether appellant's NSF charges are unconscionable under California law.

Crocker relies on the exception for cases in which the federal issue has been finally decided in the state courts, where the party seeking review might prevail on the merits in state court, and

where reversal on the federal issue would terminate any further litigation (JS 24 n.20). *See* 420 U.S. at 482-83. Even in such cases, the Court has required a demonstration that "refusal immediately to review the state court decision might seriously erode federal policy." *Id.* Crocker argues that refusal to grant review would seriously erode the congressional policy of "requiring federally insured financial institutions to set the amount of those charges at market levels, and would undermine the clear mandate of the 1980 and 1982 deregulation acts and the Comptroller's interpretive regulation" (JS 24 n.20).

The problem with this argument is that Crocker has not identified any statement of that policy in any federal statute. It has simply restated the federal interests which it infers from the statute and on which it relies for its preemption claims. But if a federal interest of this kind were sufficient to qualify for this exception to the final judgment rule, then the requirement that the state court decision "might seriously erode federal policy" would be meaningless, since whenever a federal statute is at issue, it will always be possible to identify some arguable federal interest that could be eroded. While not dispositive, the fact that the Comptroller of the Currency, who participated below, has not urged this Court to hear Crocker's appeal undercuts Crocker's claim that an important federal interest is at stake.

There is another reason why there is no final judgment on the preemption claim. Courts have been reluctant to hold contracts unconscionable. According to appellee's research, the last time the California courts held a price term in a contract unconscionable was in 1943. *Jacklich v. Baer,* 57 Cal. App. 2d 684, 135 P.2d 179 (3rd DCA). Thus, it is far from certain that appellee will prevail on the merits, which further undermines Crocker's argument that the decision below presently interferes with federal banking policy.

Crocker also argues that the interference with federal banking policy is established because the decision below will "impair[ ] the pricing and marketing flexibility needed to attract deposits." It bases this assertion on the claim that its charges are within the range of the NSF fees charges by other banks, that it is unfair to

isolate a single fee, and that its fees may reflect charges necessary to deter NSF checks (JS 11). However, the California courts have not yet determined whether these arguments are valid defenses to an unconscionability claim, and, until those issues are decided, it will be impossible to assess the impact of California's unconscionability law on the operations of national banks. Thus, if Crocker is correct that the impact of California Code § 1670.5 on its operations is relevant to the preemption question, this suggests that the Court should wait until this case has been fully adjudicated before deciding whether a substantial federal question has been raised.

CONCLUSION

For the foregoing reasons, the appeal should be dismissed, or, alternatively, the decision below should be summarily affirmed.

Respectfully submitted,

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January 1986

ADDENDUM

[Letter from Legal Advisory Services Division, Comptroller of the Currency, submitted to California Supreme Court by letter of July 30, 1984]

Aug 22, 1977

Dear Mr. _____

This refers to our recent telephone conversation in which you questioned whether the New York Banking Board's regulation which prescribes the maximum service charge that a bank may impose on a check returned for insufficient funds validly applies to national banks.

The Comptroller's Interpretive Ruling 7.8000 on service charges states simply that [a]ll charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or even discussion among banks or their officers." The thrust of the interpretation is that service charges must be determined competitively by each bank and not pursuant to any understanding or arrangement with other financial institutions.

A state law or regulation which established a maximum amount for any particular type of service charge would therefore not be in conflict with the Comptroller's ruling. A long line of cases holds that state statutes and regulations issued thereunder validly apply to national banks unless they interfere with the purposes of the national bank's creation, tend to impair or destroy their efficiency as federal agencies or conflict with paramount law of the United States. *See, e.g., Anderson Nat. Bank v. Luckett,* 321 U.S. 233 (1944); *Bank of America, National Trust & Savings Ass'n v. Lima*, 103 F.Supp. 916 (D. Mass. 1952); *Richie on Banks and Banking*, Vol. 7B 5 and cases cited therein (1973). State-imposed limitations on certain service charges would not seem to be subject to federal preemption under the criteria

established in the case law. Such a conclusion is consistent with the long recognized fact that

> National banks are subject to the laws of the state, and are governed in their daily course of business far more by the laws of the state than of the nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law. *(McClellan v. Chipman*, 164 U.S. 347 (1896)).

Pursuant to the authority granted by Section 108(9) of New York's Banking Law (4 McKinney 108(9)), the New York Banking Board has issued the following regulation:

> The maximum charge which may be imposed by a bank, trust company, savings bank or savings and loan association in connection with a check or other written order drawn upon it on insufficient funds or on uncollected balances. . . is four dollars. . . (General Regs. Banking Bd. Ch. 1 Part 32.1 (1975)).

It is important to note that the regulation applies only to a bank, trust company, savings bank or savings and loan association. Bank is defined in Section 2(1) of the New York Banking Law. (4 McKinney § 2(1)):

> The term, "bank," when used in this chapter, unless a different meaning appears from the context, means any corporation, other than a trust company, organized under or subject to the provisions of article three of this chapter.

The construction of this section by the State Attorney General and one court case offer no additional guidance useful for our purposes concerning the definition of the term "bank." *See, In re Bush's Estate*, 39 N.Y.S. 2d 633 (1943) (a building and loan association is not a bank within a meaning of subdivision 1 of

this section); 1935, Op. Atty. Gen. 404 (the receipt of deposits of money is of the essence of banking and the term "bank" as defined in this section definitely encompasses the scope of any money corporation authorized to receive deposits of money). Clearly a national bank is not "organized under" Article III of the Banking Law. Nor would it seem generally to be "subject to" the provisions of this article which essentially outlines the powers and duties of banks and trust companies and establishes a thorough regulatory and supervisory scheme. See, 4 McKinney § 94 *et seq.* The National banking system is of course separate from this scheme and is set forth in Title 12 of the United States Code. Furthermore, in the few sections of Article III which relate specifically to national banks, such as conversions or mergers between national banks and state banks, the term "national banking association" is used. See, 4 McKinney §§ 136 and 137.

It is, therefore, my opinion that the term "bank" applies only to state banks and that the New York Banking Board's regulation or maximum service charges on returned checks does not apply to national banks. If the state legislature had intended otherwise, it presumably would have included "national banking associations" within the granting authority contained in Section 108(9) of the Banking Law. The earlier interim letter written from this Office to Mr._____ who had inquired about a five dollar service charge imposed by an unnamed national bank, should accordingly be considered withdrawn. A follow-up letter to this effect will be sent to Mr._____.

Very truly yours,

William B. Glidden
Staff Attorney
Legal Advisory Services Division

[Letter from Comptroller of the Currency, submitted to California Supreme Court by letter of July 30, 1984]

Comptroller of the Currency
Administrator of National Banks
Washington, D.C. 20219

December 4, 1979

Dear Mr. Chairman:

This is in response to your letter of October 24, 1979, in which you ask this Office to comment on the legal issues involved in the imposition of bank service charges on dormant deposit accounts and other unclaimed property which is held by the bank. A bank's authority to impose service charges on dormant accounts is based entirely upon state contract law. In states which permit such charges, national banks may assess them; however, if state law restricts such charges, national banks must comply with those restrictions.

The requirement that national banks must conform their conduct to pertinent state contract law is embodied in Comptroller's Interpretive Ruling 7.7515 which provides that: "A national bank may, *consistent with contracts of deposit*, impose such service charges on dormant accounts as its board of directors determines to be reasonable." 12 C.F.R. § 7.7515 (emphasis added). While the underlying premise of this ruling is that a valid contract must exist for service charges to be deducted or interest payments stopped, it is the clear intent that state law govern all issues of contract formation, contract interpretation, and contract enforcement. Thus, your specifically enumerated questions, regarding the type of instruments upon which service charges may be imposed, the sort of notice necessary to create contracts which permit service charges, the necessity of disclosing the amount of the charge, and the reasonableness of that amount cannot be answered without specific reference to the law of the state in which the national bank is located.

Because the laws of each state may differ, and the state courts are better able to interpret and apply the pertinent law to contract disputes, it would, in our opinion, be inappropriate for this Office to arbitrarily establish a national standard regarding the permissibility and amount of such charges. Moreover, inasmuch as many of your specific questions are at issue in complex pending litigation, it would be highly inappropriate for the Comptroller to express an opinion on them. *See Bank of America v. Cory*, Civ. No. 257509 (Sacramento Super. Ct., filed *October 20, 1975)* (scheduled for assignment on December 3, 1979).

Most importantly, it should be recognized that state law, and not federal regulation, governs this issue. The Comptroller's Interpretive Ruling does not purport to preempt state contract law.

Sincerely,

John G. Heimann
Comptroller of the Currency

The Honorable
Benjamin S. Rosenthal, Chairman
Subcommittee on Commerce, Consumer,
and Monetary Affairs
Washington, D.C. 20515

[Letter from Special Assistant to Comptroller of the Currency, submitted to California Supreme Court by letter of July 30, 1984]

Nov. 29, 1967

Dear Senator Spong:

This refers to your undated communication requesting a report from this Office concerning a letter you attached from a constituent, Mr. Steve Wise, of Newport News who is concerned with 1) banks which consider accounts overdrawn when the bank's service charges cause the insufficiency and 2) banks which return checks for insufficient funds when such funds are deposited after the checks are written.

In regard to the first issue, that of service charges, it has been the consistent policy of this Office that a national bank may impose reasonable service charges for the handling of accounts and related matters. Banks customarily have an understanding with each depositor that service charges and related charges, such as those for personalized checks, will be charged directly against his account, rather than billed to him for later payment. This practice has evolved throughout years of banking operations and varies from community to community, with nearly universal satisfaction. One of the merits of a bank-depositor relationship is that it is almost entirely subject to contractual agreement, leaving customers free to deal with banks according to their individual requirements, and allowing the banks to serve their customers in an ever-increasing variety of ways.

The second matter brought up by Mr. Wise, the instance of a bank refusing to honor a check with funds that were not deposited until after the check was written, is governed by the Uniform Commercial Code effective in Virginia since January 1, 1966. Although the Code permits banks to charge a customer's account even though the charge creates an overdraft,

the language does not appear to require such action. Statutory interpretation is, of course, a matter for the courts. May we point out that all legal actions arising under the Code are private legal disputes under state jurisdiction and do not involve this Office.

If we can be of further assistance, please do not hesitate to call upon us.

Very truly yours,

R.R. Cox
Special Assistant to the
Comptroller of the Currency

Honorable William B. Spong, Jr.
U.S. Senator
Washington, D.C.

WALSH:ref 11/29/67

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No. 85-1035

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

APPELLANT'S REPLY TO MOTION TO AFFIRM OR TO DISMISS

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TABLE OF AUTHORITIES

Cases Page

Cox Broadcasting Corp. v. Cohn, 420 U.S. 469 (1975) 7
Hines v. Davidowitz, 312 U.S. 52 (1941) 4
In Re Powers' Will, 124 N.Y.S. 2d 277 (1953) 4
Jacobs v. Citibank, N.A., 92 A.D. 2d 786, 459 N.Y.S. 2d 781 (1983), *aff'd*, 61 N.Y. 2d 869, 462 N.E. 2d 1182 (1984) 4
New York Stock Exchange v. Bloom, 562 F.2d 736 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978) 5

Federal Regulations

12 C.F.R. 7.6025(c) (1985) 3

State Statutes

California Financial Code
§ 865.2 6
§ 865.4 6

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Appellant believes its jurisdictional statement responds to most of appellee's response. Accordingly, appellant briefly replies as follows: [1]

1. Appellee's main argument is that no provision of federal law requires that national banks impose "unconscionable fees" (Br. 5) and, thus, no conflict purportedly exists between federal and state law. Despite the clever working of appellee's argument, it seriously misstates the issue. Our argument is that the scheme of state court

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[1] Pursuant to Rule 28.1, the entities related to appellant Crocker National Bank are disclosed at page ii of our jurisdictional statement.

price regulation authorized by the decision below stands as an obstacle to the statutory duties of the Comptroller as well as other federal law. To take only one example, Congress has granted pervasive federal power to the Comptroller to review all of the service charges of a national bank (along with the rest of its operations) in order to regulate its safety and soundness (see JS 14-17). In exercising this power, the Comptroller examines NSF charges, along with other charges, to determine the bank's revenue base. The Comptroller also examines NSF charges to insure that they are high enough to "discourage customers from frequently writing checks in amounts greater than their account balances" (App. I at 83a; App. J at 91a). At the same time, the Comptroller recognizes his responsibility to "deal with instances of unacceptable pricing," *i.e.*, "unconscionably high fees," if encountered (App. I at 82a, 84a). NSF charges are thus reviewed from several perspectives.

After examiners review a national bank's service charges and make their decision whether to seek a modification of them, a state court may not, after the fact, conduct a separate review and order modification of the charges without impermissibly altering the calculus on which the federal examination is made. Such state court review and modification would necessarily supersede the Comptroller's determination and, thus, would stand as an obstacle to the Comptroller's duty to protect the safety and soundness of the national banking system. For example, if the examiners concluded that a reduction in service charges would threaten the revenue base of the bank and would encourage more NSF check-writing, the examiners might decide the fees are at an appropriate level and make no attempt to modify them. To permit a state court later to review and modify the same charges would effectively overrule the federal determination.

While such second-guessing is by itself inimical to the federal examination process, several additional factors

exacerbate the conflict. *First*, the criteria employed in the state court review authorized by the decision below are sharply different from the criteria used in the federal examination. For example, the decision below focuses on the "true value" of the service, the sophistication of the customer, the market structure, and the absence of meaningful choice, among other factors (App. A at 11a-12a). In contrast, the federal examination focuses principally on the safety and soundness of the bank, the related role of service charges in generating revenues and, absent instances of "unacceptable pricing," generally leaves the regulation of the amount of service charges to the market (App. I at 82a), an approach expressly repudiated by the court below. Although the decision below allows some of the federal factors to be considered in the state court review of service charges (App. A at 34a n.42), it is obvious that the two standards diverge and subject national banks to conflicting demands. *Second*, in light of the prohibition against disclosing federal bank examination reports, a national bank would be unable to disclose the results of the federal examination to the state court, thereby increasing the risk of conflicting commands. 12 C.F.R. 7.6025(c) (1985). *Third*, the conflict is all the greater if retroactive refunds are ordered, thereby upsetting several years of bank examinations and imposing potentially hundreds of millions of dollars in retroactive liabilities on a bank. In the present case, plaintiff seeks to recover for all NSF charges collected since 1973 by Crocker. To do so would undo the revenue base of many years of bank examinations conducted by the Comptroller with respect to Crocker's safety and soundness.

Thus, the issue is not whether federal law authorizes "unconscionable fees." Rather, it is, among other issues, whether a state may authorize its common law courts to review and to modify the service charges of a national bank in statewide class proceedings in a way that will necessarily supersede the Comptroller's own determina-

tions as to such charges. Plainly, there is room for only one regulator of the amount of such charges. Accordingly, state court regulation "stands as an obstacle" to the statutory duty of the Comptroller and must yield. *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941).

2. Contrary to the statement of appellee (Br. 9 n.5), the decision below conflicts with the decision in *Jacobs* v. *Citibank*, N.A., 92 A.D.2d 786, 459 N.Y.S.2d 781 (1983), *aff'd*, 61 N.Y.2d 869, 462 N.E.2d 1182 (1984). The New York Appellate Division held as follows (459 N.Y.S.2d at 783):

> It is conceded by defendant that, during certain periods, its charges exceeded those fixed by the Banking Board. However, it points out, quite correctly, that it is a federally chartered bank and thus, not subject to the strictures of the New York Banking Law. In dealing with the matters here in issue it is governed by 12 C.F.R. 7.8000 which requires only that fees charged for the services herein involved be fixed on a competitive basis and not on the basis of any agreement or understanding among banks and their officers.

The Court of Appeals affirmed, stating that "defendant, a federally chartered bank, is not subject to the fee limitations imposed by the New York State Banking Board." 462 N.E.2d at 1184. The New York courts thus held that the Comptroller's regulation (even before its 1983 amendment) governed charges set by national banks and that state law to the contrary was not applicable to national banks. This was necessarily a preemption holding since the New York Banking Law otherwise has been held to apply to national banks. *In re Powers' Will*, 124 N.Y.S.2d 277, 279 (1953).

3. Appellee argues that the Comptroller's position on preemption has changed over the years and, therefore, is not entitled to deference (Br. 12-13). Preliminarily, the extent to which the three letters cited are truly inconsist-

ent is questionable.[2] More importantly, all of the letters were written well before Congress deregulated the banking industry in 1980 and, thus, do not reflect the significant interplay between increased competition for deposits and the need, for reasons of safety and soundness, to price deposit services at market rates, as explained by the Comptroller in his formal interpretative ruling (App. I at 77a, 79a). Moreover, the letters were not formal interpretative regulations, and do not rise to the level of deliberation and care of a formal interpretative regulation, *see New York Stock Exchange* v. *Bloom*, 562 F.2d 736, 741 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 942 (1978), the latter being entitled to more deference.

Appellee also seeks to discredit (Br. 12) the Comptroller's regulation by complaining that it was issued on the eve of oral argument below. This argument was made and rejected by the California Supreme Court, which held that there is "no impropriety in an administrative agency

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[2] Although the August 22, 1977 letter (Br. 1a) states that state-imposed limitations on service charges "would not seem" to be subject to federal preemption under previous case law, the actual holding of the staff attorney's opinion was that the state legislation there in question was not intended to be applicable to national banks. Therefore, the preemption issue was not directly presented. The December 4, 1979 letter (Br. 4a) is an interpretation of a *different* interpretative ruling of the Comptroller concerning "dormant" service charges on inactive accounts. The regulation had specifically limited such charges to a "reasonable" amount. The opinion states that such reasonableness should be determined by reference to local law and, thus, incorporated local law as a guide to the reasonableness requirement. The opinion does not indicate that states may regulate the amount of *all* service charges. The November 29, 1967 letter (Br. 6a) states that a national bank may impose service charges. Nowhere in the letter is there any statement that states may regulate the amount of those charges. The only reference to state law was a statement that the Uniform Commercial Code governed the rights of a depositor in a bank with respect to refusals of the bank to honor a check and that interpretation of the UCC was a matter of state law. In sum, none of the letters holds that states may generally regulate the amount of service charges of a national bank.

issuing a regulation to clarify its position on contested issues in pending litigation" (App. A at 22a n.22).

4. Appellee erroneously states that "the bank does not provide depositors with a schedule of its services . . ." (Br. 3). Although the complaint alleges that the signature card does not identify the amount of the charge for NSF checks and that the bank does not furnish the depositor with a copy of the applicable bank "rules and regulations" (App. A at 3a), neither the complaint nor the court below stated that the bank fails to provide a schedule of service charges to customers. In fact, the decision below expressly recognized that the complaint was silent concerning whether Crocker had complied with California Financial Code §§ 865.2 and 865.4, requiring banks to make information about bank service charges available to the public in an area of the bank open to the public and requiring written advance notice of price increases to customers (App. A at 3a n.3, 5a n.6). Under California rules of pleading, therefore, it is presumed (in the absence of an allegation to the contrary) that Crocker *has* complied with the law (see JS 5 n.4). Indeed, in recognition of such disclosure, the court below indicated that Crocker had "post[ed] notice of its rates" (App. A at 5a & n.6). Moreover, plaintiff has conceded that he was aware of the amount of Crocker's NSF charges (App. C at 42a, 46a, 49a). This is thus not a case involving nondisclosure of the price term, but a case involving substantive regulation of the amount of the price term.[3]

---

[3] Appellee also argues that the brief contractual language of the signature card (which is separate from the disclosure notice) was in print so small that "many" could not read it (Br. 2). Although the court below made such a statement, the signature card is not difficult to read. The photocopy attached to plaintiff's complaint was of extremely poor quality, which may have contributed to the court's comment. The reproduction of the signature card as it appears in appellee's brief (Br. 3 n.2) demonstrates that it is readily legible. At all events, the court below held that the signature card agreement is a valid contract under California law.

5. Finally, appellee is wrong in arguing that this appeal is not ripe. Appellee suggests that Crocker has not satisfied the four-factor test of *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469, 482-83 (1975), because appellant has "not identified any statement of . . . policy in any federal statute" (Br. 16) that would be seriously eroded by refusal to grant immediate review. As stated in our jurisdictional statement (JS 18-22) and the briefs of amici curiae (*e.g.*, American Bankers Association 4-7, 10-11; Consumer Bankers Association 4-10), the 1980 and 1982 deregulation acts rest on a congressional determination that national banks must be able to price deposit account services to recover the cost of deposits and to attract and retain those deposits in the competitive marketplace. This federal policy of reliance on market forces to price bank services finds repeated expression in the legislative history of the deregulation acts (*ibid.*) and in the Comptroller's interpretative regulation (App. I at 77a-79a, 82a). Appellee cites no authority to support its contention that a state court decision that threatens seriously to erode substantial federal policy, such as the decision below, is immune from review because the federal policy on which the appeal is based appears in the legislative history or an agency interpretation of the federal statutory scheme.

The court below repudiated the Comptroller's regulation regarding the pricing of national bank service charges. Failure to grant immediate review will seriously erode the federal policy requiring national banks to price their services in accordance with federal criteria and will force banks, at least in California, to adopt the competing criteria established by the court below. For the same reason, postponed review will erode the federal statutory policy conferring exclusively on the Comptroller the duty and power to review and to modify the financial operations of national banks to ensure their safety and sound-

ness. As noted, absent immediate review, regulation of national bank service charges will be usurped, at least in California, by the state courts.

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On Appeal from the Supreme Court of the State of California

AMICUS CURIAE BRIEF OF CHICAGO CLEARING HOUSE ASSOCIATION IN SUPPORT OF JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

Whether States may regulate the reasonableness of the deposit account service charges that national banks assess against their customers, *despite* the contrary regulation of the Comptroller of the Currency and the terms and purposes of the National Bank Act and the Deregulation Acts of 1980 and 1982?

TABLE OF CONTENTS

	PAGE
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iii
INTEREST OF THE *AMICUS CURIAE*	1
THE QUESTIONS PRESENTED ARE SUBSTANTIAL	3
CONCLUSION	9

TABLE OF AUTHORITIES

	PAGE
Franklin National Bank v. *New York*, 347 U.S. 373 (1954)	6
Hines v. *Davidowitz*, 312 U.S. 52 (1941)	7
Jacobs v. *Citibank, N.A.*, 61 N.Y.2d 869, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (1984)	6
Statutes:	
Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 3501 *et seq.*	8
Garn-St. Germain Depository Institutions Act of 1982, 12 U.S.C. § 3503(c)	8
Illinois Commercial Code, Ill. Rev. Stat. ch. 26, § 3-806 (P.A. 84-1002, October 30, 1985)	6
National Bank Act, 12 U.S.C. § 24	6
Miscellaneous:	
BNA, *Daily Rep.*, No. 3, January 6, 1984	8
12 C.F.R. 7.8000(b)(2)	7
12 C.F.R. 7.8000(b)(4)	7
Comptroller's Handbook For National Bank Examiners (1977)	7
S. Rep. No. 368, 96th Cong., 1st Sess. (1979)	8

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AMICUS CURIAE BRIEF OF CHICAGO CLEARING HOUSE ASSOCIATION

With the consent of the parties, *amicus* Chicago Clearing House Association files this brief in support of the Jurisdictional Statement.[1] Amicus believes that review of the California Supreme Court's decision is a matter of great national importance and urges the Court to note probable jurisdiction.

INTEREST OF THE AMICUS CURIAE

Chicago Clearing House Association is an unincorporated association of banking institutions. Its members now consist of nine banks that have their principal places of business in Chicago,

[1]The letters granting these consents have been filed with the Clerk of the Court, pursuant to Rule 36.

Illinois: American National Bank and Trust Company of Chicago, Boulevard Bank National Association, Continental Illinois National Bank and Trust Company of Chicago, Drovers Bank of Chicago, Exchange National Bank of Chicago, The First National Bank of Chicago, Harris Trust and Savings Bank, LaSalle National Bank, and The Northern Trust Company. In addition, there are over 600 financial institutions that are affiliates of the Association.

The Chicago Clearing House's interest in this case goes beyond its status as a representative of banking institutions. Since its founding in 1865, the Clearing House has offered services permitting the daily exchanges and settlements of checks by its member institutions. Because this settlement function depends on safe banking practices, the Clearing House's mission was long ago expanded to the fostering of sound methods of banking. It has thus participated in public policy discussions, legislative proceedings, and, in some instances, judicial proceedings—all with a view to assuring the maintenance of sound methods of banking in the face of rapidly changing technology and regulations.

The Clearing House has a particular interest in whether probable jurisdiction is noted in this case. The decision of the California Supreme Court has created extraordinary uncertainty in the banking industry at a critical time in its history. Indeed, the experience of *amicus* and its members vividly demonstrates that until reviewed and set aside, the California Supreme Court's holding will have serious adverse effects on banking institutions and the nation. It will limit the ability of national banks to attract deposits, impair their efforts to deter abuses of their services, and impede the maintenance of safe and sound practices. *Amicus* thus urges the Court to resolve the conflicts among the lower courts now and determine the validity of the Comptroller's regulation in this case and at this time.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL.

In this case, the California Supreme Court invalidated a regulation of the Comptroller of the Currency that has great importance to the banking industry, the economy, and national policy. This regulation provides that, notwithstanding any contrary provision of state law, banks may establish fees for individual depositor account services on the basis of a number of factors. These include enhancement of the banks' competitive positions in attracting deposits, the deterrence of misuse of their services, and the maintenance of the safety and soundness of their institutions. The regulation further provides that these arrangements and fees are subject to the exclusive regulation of the Comptroller.

In invalidating the Comptroller's regulation, the California Supreme Court held that States have the authority to regulate the reasonableness of such charges and to order refunds of any amounts found to exceed the "true cost" of the service, plus a "reasonable profit." Under this decision, any individual deposit account fee that is deemed "excessive" by a customer can be subjected to a challenge, thereby subjecting the bank to potentially crippling refund obligations in a myriad of privately-instituted state court proceedings. The fee can further be declared unlawful, *regardless* of whether it adds to the bank's ability to gather deposits or promotes the other objectives that the Comptroller's regulation identified.

1. The California Supreme Court's decision directly burdens the exercise of important federal rights and creates extraordinary uncertainty at a critical time in the banking industry. Indeed, the experience of *amicus* and its members shows why review of this decision is a matter of paramount national importance.

The overriding fact is that the recent deregulation of the interest rates that banks may pay, and the intense competition from other kinds of financial institutions, has imposed great pressure

on banks to reprice their services. It requires banks to consider "unbundling," and charging separately, for many of the individual account services that historically were provided to customers for a single monthly fee. In many instances, the provision of the services had previously been subsidized by the below-market interest rates that banks had been required to pay; with the deregulation of interest rates, such subsidies are impossible. These efforts require that national banks have the flexibility that the Comptroller's regulation, and the pertinent federal statutes, afford. Indeed, the underlying purpose of the federal laws is that each bank should fashion its own pricing and marketing strategies so as to enhance its own safety, soundness, and ability to compete.

The experience of *amicus*'s members illustrates the point. A wide array of individual account services have been unbundled, to date, by some of the Chicago Clearing House's members. These services for which separate charges have been imposed include customer balance inquiries, preparation of cashiers checks, wire transfers of funds, preparation of duplicate statements, photocopying cancelled checks, holding statements for pick-up by customer, preparation of temporary checks, return of checks for insufficient funds, stop payments, and payments of overdrafts. The California Supreme Court's holding, by its terms, would affect each of the foregoing deposit account services. Plainly, a requirement that each fee be separately "cost-justified" would impede, if not prevent, any attempts to continue the unbundling of services.

Furthermore, contrary to the assumptions of the California Supreme Court (App. 11a, 36a n.43), there is also an enormous range in the amounts of fees that different institutions impose for the same services. For example, the fees that the Chicago Clearing House's members charge for the service at issue in this case—the processing of checks drawn on non-sufficient funds (NSFs)—range from $1 per item to $20 per item. The range in the fees reflects that different institutions have different market-

ing strategies and have given different weight to the Comptroller's other factors, in light of the unique circumstances of each institution. By way of example, a bank seeking to attract deposits from customers who seldom draw checks on insufficient funds (but use other services extensively) may establish very high NSF charges relative to both the "market" and the "true cost" of service; conversely, that bank might establish fees that are below the "market," and below cost, for other depositor services. In all events, the Comptroller regulates the reasonableness of the bank's practices.

The assurance of exclusive federal regulation under the Comptroller's flexible standards is critical to the continuation of these competitive efforts by banks to attract deposits and promote their safety and soundness. Quite plainly, the California Supreme Court's decision will end the competition among banks in setting individual fees. Because the ability to avoid lawsuits and crippling retroactive refund obligations would depend on the pricing of all services at "cost," any fees that are established would be set at cost regardless of whether different fee structures would better serve other banking objectives. Indeed, the California decision will inhibit any bank from establishing fees for *any* individual services; this is because of the obvious difficulties in "cost justifying" individual fees. Because the potential liabilities that California's holding creates are so great, moreover, the mere existence of the decision, correct or not, will have a direct effect on the ability of banks to "unbundle" services to promote their financial health and safety. Review of the decision is thus of the utmost national importance.

The importance of review is further accentuated by the fact that California's invalidation of the Comptroller's regulation has encouraged other kinds of state regulation of individual deposit account service fees. In the wake of the California decision, for example, Illinois passed a law that essentially prohibits the impo-

sition of returned deposited item charges ("RDI charges").[2] These are the fees that are imposed on a bank customer (*e.g.*, a merchant) who deposits a check that is drawn on a second bank, but the second bank dishonors the check and returns it. Each of *amicus*'s member banks had previously assessed such RDI charges. Indeed, these epitomize the fees that can deter abusive use of bank services (by giving merchants an added incentive to assure that checks they deposit will not be returned for non-sufficient funds[3]) and help assure the safety and soundness of the institutions. A national decision upholding the Comptroller's regulation would prevent this and other state interference with these important federal objectives.

2. There similarly is no question that the decision of the California Supreme Court in this case presents federal questions that are substantial as well as vitally important. Indeed, the decision squarely conflicts with the decision in *Jacobs* v. *Citibank, N.A.*, 61 N.Y.2d 869, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (1984). There, the New York Court of Appeals held that under the National Bank Act, the regulation of the amount of a national bank's service charges is the exclusive province of the Comptroller of the Currency.

The California Supreme Court's decision also conflicts with this Court's earlier decisions construing the National Bank Act. This Court has held that the Congressional authorization of national banks to receive deposits and exercise "all such incidental powers as shall be necessary to carry on the business of banking," 12 U.S.C. §24 (Seventh), preempts state prohibitions on promotional activities (such as advertising) that further the banks' efforts to attract deposits. *Franklin National Bank* v. *New York*, 347 U.S. 373 (1954). As explained above, the California holding imposes, if anything, a greater burden on national banks' efforts

[2]Ill. Rev. Stat. ch. 26, §3-806 (P.A. 84-1002, October 30, 1985).

[3]If a merchant passes the RDI charges on to the drawer of the check—as many do—the incentives would be heightened further.

to market services and gather deposits. *See* p. 5, *supra*. Under any view, moreover, the power to charge for services rendered to depositors is necessary to carry on the business of banking and to attract deposits.

The decision in the instant case also conflicts with the terms and purposes of the National Bank Act in a second respect; it encroaches on the exclusive power and duty of the Comptroller of the Currency to enforce banking laws against national banks. Congress has given the Comptroller the authority to examine the operations of national banks not only to ensure compliance with applicable law, but, more importantly, to promote the safety and soundness of each institution. Yet the California decision permits state courts to review national bank pricing policies after those very policies have been examined and approved by the Comptroller. Such state regulation "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941).

Indeed, in this instance, the state regulation, by its very terms, would conflict with specific regulatory policies of the Comptroller. By ordering that each service charge be individually cost-based, California would prevent the Comptroller from implementing its policies that service charges be set high enough to deter the writing of checks in amounts greater than account balances (*see Comptroller's Handbook For National Bank Examiners* §301.1 (1977); 12 C.F.R. 7.8000(b)(2)), and otherwise advance the deposit-gathering abilities or safety of the institutions. 12 C.F.R. 7.8000(b)(4). The California Supreme Court's decision places national banks in the untenable position of choosing between violating the provisions of the Comptroller's regulation or subjecting themselves to state court litigation with the risk of incurring enormous refund obligations.

Finally, the California Supreme Court's decision conflicts with the objectives of the Depository Institutions Deregulation and

Monetary Control Act of 1980, 12 U.S.C. §§3501 *et seq.*, and the Garn-St. Germain Depository Institutions Act of 1982, 12 U.S.C. §3503(c), which ended the limitations on interest rates payable by depository institutions, 12 U.S.C. §3501(b). In these Acts, Congress recognized that national banks could not pay these higher, competitive interest rates unless they also had the freedom to increase service charges that the California Supreme Court has denied them. *See* S.Rep. No. 368 at 39 (Sen. Cranston); S.Rep. No. 368 at 37-38 (Sen. Morgan); BNA, *Daily Rep.*, No. 3, Jan. 6, 1984 at A-10 (Rep. Annunzio).

CONCLUSION

For the reasons stated, probable jurisdiction should be noted.

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BRIEF OF AMICUS CURIAE CONSUMER BANKERS ASSOCIATION IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE CONSUMER BANKERS ASSOCIATION	1
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. The Decision Below Is Incompatible With Federal Deregulation Of The Financial Services Industry	4
II. The Decision Of The Court Below Is Inconsistent With Prior Preemption Determinations By This Court, The Lower Courts And The Federal Regulatory Agencies	11
III. The Problem Presented In This Case Is National In Scope	12
CONCLUSION	13

TABLE OF AUTHORITIES

Cases: Page

Conference of State Bank Supervisors v. Conover, 710 F.2d 878 (D.C. Cir. 1983) 11
Federal Home Loan Bank Board v. Empire, —— F.2d —— (10th Cir. 1985) 11
Fidelity Federal Savings and Loan Assn. v. de la Cuesta, 458 U.S. 141 (1982) 11
Franklin National Bank v. New York, 347 U.S. 373 (1954) 11
Hines v. Davidowitz, 312 U.S. 52 (1941) 8
Jacobs v. Citibank, N.A., 459 N.Y.S. 2d 781 (App. Div. 1983), *aff'd*, 474 N.Y.S. 2d 464 (1984) 12
Tiffany v. National Bank of Missouri, 85 U.S. (18 Wall.) 409 (1874) 11

Federal Statutes and Regulations:

12 U.S.C.

§ 24 5
§ 484 5
§ 1832 4
§ 3502 4
§ 3503 4
§ 3504 4

12 C.F.R.

§ 217.7 (repealed 1980) 5
§ 329.6 (repealed 1980) 5
§ 526.3 (repealed 1980) 5
§ 7.8000 11

Public Laws:

Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 4
The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 4

TABLE OF AUTHORITIES—Continued

Congressional Materials:	Page
Competition & Conditions in the Financial System, Part I: Hearings Before the Senate Committee on Banking, Housing and Urban Affairs, 97th Cong., 1st Sess. (1981)	6
Depository Institutions Deregulation Act of 1979, Parts I, II & III: Hearings Before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing, and Urban Affairs, 96th Cong., 1st Sess. (1979)	7, 8
S. Rep. No. 368, 96th Cong., 1st Sess. (1979)	5, 6, 7
S. Rep. No. 407, 95th Cong., 1st Sess. (1977)	6
State Statutes:	
California Civil Code § 1670.5	12, 13
Ill. Rev. Stat. Ch. 22, § 3806	13
Other Authorities:	
American Banker	
May 19, 1982	9
October 22, 1985	8
Business Week	
March 22, 1985	8
Canner & Kurtz, *Service Charges as a Source of Bank Income and Their Impact on Consumers,* Federal Reserve Board of Governors Staff Study No. 145 (1985)	9, 10
Consumer Federation of America, *Bank Fees on Consumer Accounts: A 10-State Survey* (May 17, 1984)	9
New York Times	
May 1, 1983	8
March 22, 1985	8
September 20, 1985	9
December 9, 1985	8

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-1035

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

BRIEF OF AMICUS CURIAE CONSUMER BANKERS ASSOCIATION IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

INTEREST OF AMICUS CURIAE CONSUMER BANKERS ASSOCIATION

Amicus Curiae Consumer Bankers Association ("CBA") was organized in 1919 to provide a voice for the retail banking industry. Membership in CBA is open to all federally insured depository institutions, including national and state-chartered banks, savings and loan associations and credit unions. CBA members currently hold over 80% of the consumer deposit accounts and over 70% of the consumer credit held by commercial banks nation-

wide. CBA's membership includes depository institutions in almost every state.[1]

The financial services industry is in the midst of a period of intense and unprecedented competition, engendered by the progressive congressional deregulation of the financial services industry since 1978 and by the specific congressional determination that depository institutions should pay market rates of interest on deposits. To respond effectively to these federal policies, and to the resulting pressures of the competitive marketplace, CBA members must have the flexibility to price deposit account services at levels sufficient to attract and retain deposits and to defray increased interest expense. The decision below, by authorizing individual trial judges to substitute their subjective judgments for the judgment of the freely competitive market with respect to the pricing of those services, will adversely affect the ability of amicus' members and all depository institutions to compete successfully in the marketplace.

Until this litigation, Congress' comprehensive scheme of deregulation was understood by the industry and interpreted by the legal community and the Office of the Comptroller of the Currency, amongst others, to preempt the type of state-law pricing restrictions applied by the court below. This case presents directly and unavoidably the question whether state law restrictions on deposit account service charges are preempted by federal law.

Because such restrictions threaten to radically alter the overall economics of the deposit account with serious implications for the ongoing safety, soundness, and competitiveness of federally insured depository institutions, amicus respectfully urges review by this Court at this time to resolve the substantial federal issues presented

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[1] Pursuant to Supreme Court Rule 36.1, amicus curiae CBA has obtained the written consent of counsel of record for all parties hereto to the filing of this brief.

and to provide needed certainty to the financial services industry.

SUMMARY OF ARGUMENT

Until this litigation, state review and modification of deposit account service charges, as approved by the decision below, was understood to be preempted as to all federally-insured depository institutions by federal banking statutes and regulations, and in particular by the 1980 and 1982 legislation deregulating the financial services industry. That legislation removed artificial ceilings on the rate of interest payable on demand deposit accounts and left determinations about the cost and flow of those deposits to the forces of the competitive marketplace.

In authorizing payment of market rates of interest on deposits, Congress necessarily recognized that the cost of funds to financial institutions would increase, and, therefore, that charges for servicing deposit accounts (charges which had previously been subsidized by paying below-market interest rates) would also increase to the extent permitted by competition. Depository institutions must be able to recover market costs on deposit account services in order to continue paying market rates of interest on those accounts. Congress expected that this "unbundling" of financial services and shift to explicit pricing would redound to the ultimate benefit of consumers, who would receive market returns on deposits and pay for only those services they used.

The decision below, holding that states may impose artificial, ill-defined and, even worse, *below* market limits on service charges, severely frustrates Congress' objectives in deregulating the financial services industry. Moreover, the decision below *directly contradicts* an interpretive ruling of the Comptroller of the Currency ("OCC") upon which the national financial services industry had every reason to rely. Worse, this direct refutation of the OCC regulation has created a general

uncertainty as to the reliability of similar preemption interpretations by the OCC and other federal regulators.

There is an immediate and compelling need for this Court to address the merits of the preemption issues raised by appellant. The decision below is part of a widespread challenge to depository institution service charges nationwide. Twenty-eight such cases are now pending in California. Similar litigation has already been initiated in Oregon and Alaska, and legislation has been enacted or is pending in other states that would prohibit depository institutions from charging market rates for their services. This appeal presents virtually the same preemption issues posed by all of these state-law efforts to limit depository institution service charges and affords this Court an opportunity to reconcile the answers to those issues with its consistent rulings on preemption in the area of federal banking law. Because of the vast sums involved and the nationwide character of the problem, CBA respectfully urges this Court to reach the merits of this appeal at this time.

ARGUMENT

I. The Decision Below Is Incompatible With Federal Deregulation Of The Financial Services Industry

In 1980 and 1982, Congress mandated a phase-out of long-standing restrictions on the rate of interest that federally insured depository institutions could pay on short term time deposits; Congress also authorized such institutions to begin to offer interest-bearing checking accounts (NOW Accounts) and money market accounts. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132; Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (pertinent portions codified at 12 U.S.C. §§ 1832, 3502-3504). Congress recognized that as a consequence of its deregulation of the interest paid on deposits, financial services would become "unbundled,"

and depository institutions would begin to price explicitly deposit account services that had previously been subsidized by artificially low interest rates paid on deposits. Congress, therefore, fully expected that service charges on deposit accounts would increase as a result of the payment of market interest rates on those deposits. The decision below, by authorizing courts to require depository institutions to offer deposit account services at *below*-market fees while nonetheless paying market rates of interest on deposits, is fatally at odds with the federal goals of deregulation.[2]

As appellant notes, before 1980, federally insured institutions had been prohibited from paying market rates on time deposits of less than $100,000. 12 C.F.R. §§ 217.7, 329.6, 526.3 (*repealed* 1980). This had resulted in "disintermediation"—the flow of funds out of federally insured institutions into "money-market" funds paying higher, market rates of interest. Moreover, these pre-1980 restrictions had led banks to compete for deposits through "gifts, free services and more convenience," which had increased the cost of deposits. S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). In acting to deregulate the industry in 1980 and 1982, Congress believed that "many depositors would prefer to receive interest income, which they can spend as they choose, rather than having to accept this implicit interest." *Id.*

As early as 1977, the Senate Committee on Banking, Housing and Urban Affairs stated in the context of hearings on NOW accounts that if all financial institutions were authorized to offer such accounts, "competition

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[2] The appellant's arguments herein are particularly persuasive. (Jurisdictional Statement 18-22) In addition to the 1980 and 1982 Acts, appellant relies on two sections of the National Bank Act, 12 U.S.C. § 24 (Seventh) and 12 U.S.C. § 484, as sources of federal preemption (Jurisdictional Statement 8-17). While limiting its discussion herein, amicus nonetheless believes that the cited sections of the National Bank Act represent independent sources for preemption contrary to the decision below.

for consumer deposits will be active, and should result in improved quality and variety of consumer financial services," S. Rep. No. 407, 95th Cong., 1st Sess. 8 (1977). This theme is consistently repeated throughout the legislative history of the 1980 and 1982 Acts. See, e.g., Competition and Conditions in the Financial System, Part I: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong., 1st Sess. 51, 55 (1981) (benefits of competition vis-a-vis regulation) (remarks of Frederick H. Schultz, Vice Ch., Bd. of Gov. of the Fed. Res. System); *id.* at 31, 33 ("The ultimate beneficiary of [deregulation] would be the consumer or other user of depository institution services whose special conveniences could be more readily addressed.") (statement by Donald T. Regan, Secretary of the Treasury). See also id. at 63, 65 ("[O]ur present framework is increasingly out of touch with the market realities. What ever reform occurs elsewhere, the failure to address this issue will assure increasingly inefficient and costly regulation.") (statement of John G. Heimann, Comptroller of the Currency).

The Senate Report to the 1980 Act emphasized that Congress' intent in providing NOW account authority was to:

> allow financial institutions to compete with one another on the basis of price. The [then existing] prohibition against payment of interest on demand deposits on the other hand, necessitates nonprice competition which leads to inefficiencies and misallocations of scarce resources.

S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). These views mirrored those of the Comptroller, who testified while the bill was still in committee that:

> the time has come to dismantle governmental restrictions which have outlived their usefulness and often serve only to protect inefficient competitors. *We must*

> *come to rely on the market mechanism* as the most efficient allocator of resources and determiner of prices. Substitution of governmental judgement for that of the depository institutions and the marketplace is arbitrary.

Depository Institutions Deregulation Act of 1979, Part II: Hearings Before the Subcom. on Fin. Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 96th Cong., 1st Sess. 89, 97 (1979) [hereinafter "Deregulation Hearings"] (emphasis added). It is respectively submitted that the decision below is precisely the type of arbitrary, non-price related judgment criticised in the foregoing statements.

In deregulating interest rates, Congress acknowledged that the removal of ceilings would lead to increases in bank services charges. For example, Senator Cranston stated in the Senate Report:

> It seems clear that if institutions are going to pay higher interest rates, and if market rate money market certificates are going to be available in $1000 denominations, that *institutions are going to have to charge more for the services they offer* and the money they lend.

S. Rep. No. 368, 96th Cong., 1st Sess. 39 (1979) (emphasis added).

Similarly, Senators Tower, Garn, and Lugar anticipated that:

> the payment of interest on transaction balances could ultimately result in an *"unbundling" in the pricing of financial services to the public.* This would result in the public *paying explicitly for services* and being explicitly paid, in turn, for funds provided to depository institutions

Deregulation Hearings, supra, Pt. I at 78 (emphasis added).[3]

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[3] Significantly, representatives of the financial industry testified regarding the upward pressure that deregulation would place on

In short, Congress fully appreciated that, to the extent competition permitted, banks would implement service charges on deposits in such amounts as were necessary to balance the competitive market rates paid on deposits. The decision below substantially thwarts this goal: it authorizes state courts to require a bank to offer services at something other, and even *less*, than their market price. In so doing, it substitutes the court for the competitive market as the regulator of prices. Thus, as appellant argues, state regulation of deposit account service charges frustrates the accomplishment and objectives of Congress, *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941), and is, therefore, preempted.

Experience with deregulation confirms that Congress was justified in its reliance on the pricing mechanisms of the marketplace, unfettered by state interference of the kind contemplated and undertaken by the court below. Competition for deposits in the wake of deregulation has been vigorous. *E.g.*, N.Y. Times, Dec. 9, 1985, at 32, col. 6 (nat'l. ed.) ("continued competition for deposits"); American Banker, Oct. 22, 1985, at 29, 30, col. 4 ("competition for deposits has escalated"); Business Week, March 22, 1985, at 100, col. 2 ("competition . . . is fiercer than ever"); N.Y. Times, May 1, 1983, § 3, at 1, col. 3

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deposit account service charges. *See Deregulation Hearings, supra*, Pt. II, at 134, 143 (testimony of John H. Perkins and Robert W. Renner on behalf of the American Bankers Association) (depositors will be "paying more in service charges"); *id.* at Pt. III, 12, 29 (statement of J. Alvin George, Ch. Credit Union Nat'l Ass'n) ("the consumer will receive the full value of his money in the form of explicit interest, and will pay only for those services he 'consumes' "); *id.* at 171, 172 (statement of Thomas F. Bolger, 1st V.P. Independent Bankers Ass'n) ("the increased costs of NOW accounts will force institutions offering them to go to explicit pricing of all their services, and it is inevitable that service charges . . . will be increased for regular checking accounts as well as NOW accounts").

("brutal competition"); American Banker, May 19, 1982, at 4, col. 3 ("marketing warfare"). Moreover, as Congress anticipated, competition for, and higher returns on, deposits go hand in hand with explicit pricing of bank services. N.Y. Times, Sept. 20, 1985, § A at 30, col. 1 ("What customers are discovering in return [for higher interest deposits] is that they must pay the full cost of the services they receive.")

Competition for deposits has not been limited to interest rates, but also extends to service charges, including NSF charges. A recent study by the Staff of the Board of Governors of the Federal Reserve System concludes that:

> [w]hen shopping for banking services, consumers face a *complex array of service options and charges*, especially for checking accounts. The *level of service charges for each service varies widely* within and among bank size categories as well as by geographic location.

Canner & Kurtz, *Service Charges as a Source of Bank Income and Their Impact on Consumers*, Federal Reserve Board of Governors Staff Study No. 145 at 17 (1985) ("Fed. Res. Study No. 145") (emphasis added). Similarly, a nationwide survey conducted last year by the Consumer Federation of America, while generally critical of bank service charges, nonetheless reports that NSF charges at the 91 institutions surveyed ranged from $7 to $20, with a typical charge of $10 or $15. *Bank Fees on Consumer Accounts: A 10-State Survey* (May 17, 1984).

The Federal Reserve Staff Study emphasizes that recent service charge increases must be viewed against the "dramatic" rise in banks' interest expense attributable mainly to the 1980 deregulation act. The Study observes that:

> [a]s a result of higher expenses, the net return to banks on personal checking accounts in 1983 was either about the same or somewhat lower than in 1979, depending on bank size . . . This finding suggests that *the increase in service charges and fees over the period was just sufficient to maintain a nearly constant return to banks* for providing the average personal checking account.

Fed. Res. Study No. 145 at 6 (emphasis added). Indeed, the Study goes on to note that, notwithstanding these increases, "service charges and fees were a relatively more important source of personal checking account revenue before the 1980 Deregulation Act then they were in 1983." *Id.* at 7.[4]

It is also noteworthy that in 1983, the "break-even balance"—the average balance needed to generate sufficient interest income to cover the costs of offering a personal checking account—was $1,380 for interest-bearing checking accounts and $692 for non-interest-bearing checking accounts. *Id.* at 8. The substantial overall costs of providing checking accounts and the competitive pressures engendered by deregulation attest to the wisdom of appellant's arguments (Jurisdictional Statement 11) and Congress' intentions. Depository institutions must retain the requisite flexibility to price services to offset the costs of the account, limited solely by the constraints of the competitive marketplace, not by judicial fiat as in the case below.

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[4] The Study concludes that service charges and fees represented on average 18% of bank income on personal checking accounts in 1983, compared with 19.3% in 1979. *Id.* at 8. Average monthly income per personal checking account, including fees and service charges, was $1.91 in 1983; excluding service charges and fees, the average personal checking account would generate a loss of $1.72 per month. *Id.* at 7.

II. The Decision Of The Court Below Is Inconsistent With Prior Preemption Determinations By This Court, The Lower Courts And The Federal Regulatory Agencies

While this case is clearly distinguishable on its facts, and involves other aspects of banking practices, the holding below appears inconsistent with the approach of this Court and others in ascertaining the relationship between federal and state laws affecting financial institutions.

This Court has numerous times affirmed the preeminence of the policies of the National Bank Act over conflicting state law. See, e.g., *Franklin National Bank v. New York*, 347 U.S. 373 (1954) (state law limiting national bank advertising preempted); *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874) (national banks may export home-state interest rates notwithstanding contrary state law.)

More recently, this Court has acknowledged the preemptive effect of agency regulations under the Home Owners Loan Act. *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141 (1982) (state laws restricting due-on-sale clauses preempted). See also, *Conference of State Bank Supervisors v. Conover*, 710 F.2d 878 (D.C. Cir. 1983) (similar preemptive effect given to regulations of the Comptroller of the Currency); *Federal Home Loan Bank Board v. Empire*, —— F.2d —— (10th Cir. 1985) (state advertising restrictions inapplicable to federal savings associations).

Similarly, the case below directly contradicts the Comptroller of the Currency's Interpretative Ruling 7.8000, 12 C.F.R. § 7.8000 ("the Ruling") regarding the imposition of service charges by national banks. The Ruling recognizes the primacy of marketplace pricing and the longstanding federal law occupation of the area of deposit account banking services. The Ruling em-

braces principles expressly recognized by the OCC and relied upon by the banking industry for over 20 years.[5]

These cases and rulings suggest that this Court, lower federal and state courts, and the regulatory agencies have in the past given considerable weight to the policy objectives of the federal banking laws, as against the regulatory activities of the states. The financial services industry has, in turn, come to rely on the primacy of federal pronouncements in this area. These facts underscore the need for prompt review of this case. If the decision of the California Supreme Court stands unchallenged, the scope of those earlier determinations is brought seriously into question, interstate banking activity is substantially burdened, congressional objectives are thwarted, and unjustifiable harm may be visited nationwide upon the financial services industry.

III. The Problem Presented In This Case Is National In Scope

Though this case comes to this Court on appeal from a decision of the Supreme Court of California construing a California statute—California Civil Code § 1670.5, the preemption issues raised herein have nationwide significance. In addition to the 27 similar cases now pending in California, there are two NSF cases now on appeal in the Oregon state courts. Another two cases have recently been filed in Alaska. All of these cases include claims that defendant's charge for processing NSF checks exceeds the cost of providing the service to an unconscion-

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[5] Amicus CBA concurs with the detailed arguments on these points framed by the amicus brief filed by the OCC herein. In particular, amicus CBA respectfully directs the Court's attention to the discussion therein of *Jacobs v. Citibank, N.A.*, 92 A.D. 2d 786, 459 N.Y.S. 2d 781 (App. Div. 1983), *aff'd*, 61 N.Y. 2d 869, 462 N.W. 2d 1182, 474 N.Y.S. 2d 464 (1984) where it was decided that the Ruling preempted state law restrictions on NSF charges levied by national banks located in New York.

able extent. Because other jurisdictions recognize the doctrine of unconscionability codified at Section 1670.5 of the California Civil Code, amicus expects that additional cases will be filed, especially if this Court refuses to hear this appeal.

Nor are efforts to limit the levels of depository institution services charges restricted to the courts. Illinois has recently enacted legislation on the subject. Ill. Rev. Stat. Ch. 22, § 3806 (1985). Legislation is also currently pending in Pennsylvania that would impose price ceilings on various services associated with checking accounts.

These and other judicial or statutory limitations on deposit account service charges that may follow on the heels of the decision below raise the same preemption issues that are presented on this appeal. They threaten a massive disruption of the national marketplace through the erection of a patchwork of arbitrary and inconsistent restrictions. Given the large sums that are potentially at issue and the substantial litigation expense involved in such suits (especially in the California litigation that has been pending since 1977), the safety and soundness of the federally insured depository system may be severely eroded. As a result, there is extraordinary need for this Court to address the permissibility of state regulation of deposit account service charges at this time.

CONCLUSION

As discussed herein and in appellant's jurisdictional statement, the court below erred in concluding that state regulation of deposit account service charges was not preempted by federal law. Nevertheless, that decision is controlling in California, and is potentially persuasive authority elsewhere. Because the validity of state regulation of depository institution service charges affects depository institutions and their customers nationwide,

amicus CBA respectfully urges this Court to address the merits of this appeal.

Respectfully submitted,

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CROCKER NATIONAL BANK,

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BRIEF OF
AMICI CURIAE MIDLANTIC BANKS INC.,
FIRST FIDELITY BANCORPORATION,
HORIZON BANCORP, AND
PHILLIPSBURG NATIONAL BANK

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF THE *AMICI CURIAE* 1

SUMMARY OF ARGUMENT 4

ARGUMENT 6

REPRICING BY STATE COURTS OF COMPETITIVELY DETERMINED BANK SERVICE FEES VIOLATES FEDERAL LAW AND IS PREEMPTED. 6

A. Background 7

B. The Effect of the Decision Below 9

1. The Decision Below Conflicts with Federal Deregulation Efforts 10

2. The Decision Below Threatens Banks' Safety and Soundness 14

3. The Decision Below Interferes with the Comptroller's Responsibilities 15

CONCLUSION 18

TABLE OF AUTHORITIES

Page

CASES:

Albrecht v. Herald Co., 390 U.S. 145 (1968) 13

California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980) 14

Conference of Federal Savings and Loan Associations v. Stein, 604 F.2d 1256 (9th Cir.), aff'd per mem., 445 U.S. 921 (1979) 16

Conference of State Bank Supervisors v. Lord, 532 F.Supp. 694 (D.D.C. 1982) 12

Franklin Nat'l Bank v. New York, 347 U.S. 373 (1954) 12

Hines v. Davidowitz, 312 U.S. 52 (1941) 13

National State Bank v. Long, 630 F.2d 981 (3d Cir. 1980) 16

Northeast Bancorp v. Board of Governors, 86 L.Ed. 2d 112 (No. 84-363) (1985) 14

Toker v. Westerman, 113 N.J. Super. 452, 274 A.2d 78 (Dist. Ct. 1971) 2

STATUTES:

Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132 7

5 U.S.C. 702 10

12 U.S.C. 24 12

12 U.S.C. 484 16

12 U.S.C. 3501-3505 7

Cal. Civ. Code. 1670.5 2

N.J. Stat. Ann. 12A :2-302 (1962) 2

TABLE OF AUTHORITIES—Continued

Page

REGULATIONS:

12 C.F.R. 217.7 (repealed 1980) 7
12 C.F.R. 329.6 (repealed 1980) 7
12 C.F.R. 526.3 (repealed 1980) 7
12 C.F.R. 7.6025 16
12 C.F.R. 7.8000 ..... 9, 17
46 Fed. Reg. 18934 (1981) 12
48 Fed. Reg. 54319 (1983) 9, 17
49 Fed. Reg. 28237 (1984) 9
50 Fed. Reg. 32003 (1985) 4

LEGISLATIVE MATERIALS:

A. 3982, 201st N.J. Legislature (1984-85) 14
A. 4339, 201st N.J. Legislature (1984-85) 14
A. 4343, 201st N.J. Legislature (1984-85) 14
S. 3226, 201st N.J. Legislature (1984-85) 14
S. 3506, 201st N.J. Legislature (1984-85) 14
S. Rep. No. 96-368 (1979) 8

OTHER AUTHORITIES:

American Banker (May 19, 1981) 17
American Banker (May 15, 1984) 17
Carron, *The Plight of the Thrift Institutions*, 1981 8
Gorinson & Manishin, *Garn-St Germain: A Harbinger of Change*, 40 Wash. & Lee L. Rev. 1313 (1983) 8
Posner, *Economic Analysis of Law* (2d ed. 1977) 13

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INTEREST OF THE AMICI CURIAE

This *amicus curiae* brief is filed on behalf of a number of New Jersey banks and bank holding companies (hereinafter referred to collectively as "New Jersey *amici*") in support of the Jurisdictional Statement filed by appellant Crocker National Bank ("Crocker").[1] Each

[1] The institutions on behalf of which this brief is filed are Midlantic Banks Inc., First Fidelity Bancorporation, Horizon Bancorp and Phillipsburg National Bank.

New Jersey *amicus* operates one or more nationally chartered banks that accept deposits from the general public in accordance with and subject to the rules and regulations of the Comptroller of the Currency (the "Comptroller"). These deposits are insured pursuant to the provisions of the federal deposit insurance program.

The decision below purports to set aside a regulation of the Comptroller that directs national banks generally to establish service fees in accordance with competitive market conditions. Specifically, the California court struck down this regulation to the extent that it would permit a national bank to price service fees at a level determined by subsequent state judicial scrutiny to be in excess of "cost" plus a "reasonable" profit. New Jersey *amici* are potentially directly affected by this decision. The banks operated by New Jersey *amici* levy service charges of the same type as those charged by Crocker and challenged by the plaintiff in this case. Moreover, the holding below is especially likely to affect New Jersey *amici* because it rests on a general theory of "unconscionability" that could be adopted in New Jersey absent a finding of federal preemption.[2] If this were to happen, service fees

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[2] The statute relied upon by the California court, Cal. Civ. Code 1670.5, tracks the language of the basic unconscionability provision of the Uniform Commercial Code, enacted in New Jersey as N.J. Stat. Ann. 12A:2-302 (1962). As noted by Crocker, Jurisdictional Statement at 6, the decision below is the first known example where a price not in excess of the fair market price was nonetheless held to be potentially unconscionable. *Cf. Toker v. Westerman*, 113 N.J. Super. 452, 274 A.2d 78 (Dist. Ct. 1971) (price equal to 2-1/2 times reasonable market value held to be unconscionable).

charged by New Jersey *amici* in accordance with competitive conditions and the Comptroller's regulations could nevertheless be reduced and refunded as a result of state court proceedings.

If the decision below is not reversed, New Jersey *amici* will be faced with an untenable dilemma. On the one hand, if they continue to comply with the regulations and directives of the Comptroller, they run the risk that New Jersey courts will adopt this newly announced application of what the California court characterized as a consequence of the principle of unconscionability and might impose retroactive refund liability for service fees that are determined to be competitive but are nevertheless, in a court's judgment, "excessive". On the other hand, if New Jersey *amici* do reduce their service fees, this would reduce a significant source of revenue. In that event, New Jersey *amici* would then have to choose between accepting lowered levels of income or reducing the rates they pay on deposits. The former choice has serious implications for the safety and soundness of banking institutions, and the latter may lead to an erosion of the deposit base in favor of financial institutions in other jurisdictions or the rapidly growing variety of non-bank savings vehicles, including not only the money market mutual funds that have become a formidable factor but numerous other recent entrants into the financial services market. No matter which choice the banks make, their ability to compete effectively in a deregulated financial services environment will be severely undercut. Worse yet, banks that try to predict what level of charges will pass subsequent state judicial muster will still face the specter of contingent liability while they abide a conclusive judicial deter-

mination that may be many years in the making. None of these alternatives is consistent with the strong federal policy, particularly applicable in the case of federally chartered and insured national banks, to maintain the health and stability, *i.e.*, the safety and soundness, of the nation's banking system.

SUMMARY OF ARGUMENT

Prior to 1980, both state and federally chartered depository institutions throughout the United States, including New Jersey *amici*, were severely restricted by law in the amount of interest they could pay on their federally insured deposits. As a result, these institutions competed for deposits on the basis of various non-price considerations, including the rendering of services at little or no charge.

Since 1980, however, interest rates have been deregulated, and competition for deposits has centered on institutions' willingness and ability to pay market rates of interest. In accordance with Congressional expectations, banks have unbundled their services and priced each according to market conditions. This has been particularly true in the case of national banks, such as those of the New Jersey *amici*, which have been urged by directives of the Comptroller to become increasingly active participants in the developing deregulated marketplace for financial services. See, *e.g.*, 50 Fed. Reg. 32003 (1985) (repealing limits on free checking accounts in order to permit newly established banks to compete more effectively).

If permitted to stand, the decision below will upset the Congressionally mandated preference for market forces. The reasoning of the California court would per-

mit state judiciaries to regulate important sources of bank revenue to sub-competitive levels. Depository institutions will likely be faced with a multiplicity of rules stemming from the disparate decisions of the various jurisdictions in our federal system, with the potential for contradictory variety exceeded only by the consequential dislocations in the nation's banking system. The ability of a court to impair a bank's ability to pay market rates of interest on deposit accounts (by forcing the reduction of service fee income) would be a direct and unprecedented interference with the bank's ability to attract those deposit accounts. While such a judicial assertion of power may be viewed with concern generally, it is particularly inappropriate in the case of federally chartered national banks, whose powers to attract deposit accounts are statutorily protected.

In addition, the decision below poses a very real and unprecedented risk that millions of dollars in refund liability will be imposed on banking institutions for fees that were competitive when charged but nevertheless are subsequently held to be "unconscionable". The manifest threat to the safety and soundness of the nation's banks from this combination of anti-competitive regulation and threat of retroactive refunds is a critical concern, not only because of the importance of the banking system to the nation's economic well-being, but also because, in extreme cases, of the potential claims on the Federal Deposit Insurance Corporation caused by the erosion to the profitability of banking institutions.

Finally, this Court should not uphold the intrusion of this state court holding into the still evolving market

place for financial services. Plaintiff has not directly challenged the authority of the Comptroller of the Currency to regulate national banks. Rather, the court below entertained, in the guise of consumer protection, a collateral attack on that authority as well as on the Congressionally mandated deregulation of the banking system. Such an attack, if permitted to succeed, can too easily injure the developing competitive marketplace for financial services by undercutting the capacity of banks, and most particularly of national banks, to participate effectively in that market. Banks simply cannot comply with both the federal mandate to price their services competitively in accordance with market factors in a deregulated environment and the California court's newly announced application of the doctrine of unconscionability. This direct conflict compels the conclusion that federal law preempts any attempt by a state court to force bank service charges to sub-competitive levels.

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ARGUMENT

REPRICING BY STATE COURTS OF COMPETITIVELY DETERMINED BANK SERVICE FEES VIOLATES FEDERAL LAW AND IS PREEMPTED.

At issue in this case is whether individual state courts have the power to require a bank chartered by the federal government to charge service fees at less than market levels. The specific fees attacked by plaintiff are those charged when checks are written on accounts that do not contain sufficient funds, referred to by the parties as

"NSF" charges. Under the broad language of the decision below, however, the holding can be read to apply to all service fees charged by federally chartered banks. The California Supreme Court held that the doctrine of unconscionability may be used to compel substantial reductions and refunds of NSF charges (and, by implication, of other bank service fees) if they exceed "cost" plus a "reasonable" profit, even though that level is below the discernible market range for such fees. In reaching this conclusion, the California court acknowledged, but rejected as "palpably erroneous", the opposite view of the Comptroller of the Currency, who has ruled that service fees must be allowed to reach their natural market level in order to enable national banks to compete successfully for deposits in today's ever-increasingly competitive environment, and, in the case of NSF charges, to discourage the writing of NSF checks which now number in the hundreds of millions annually.

A. Background.

For nearly 50 years prior to the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (the "1980 Act"), codified at 12 U.S.C. 3501-3505, the ability of depository institutions, including New Jersey *amici*, to attract deposits by the payment of interest was strictly regulated, most notably by Regulation Q and related provisions promulgated by the Federal Reserve Board. 12 C.F.R. 217.7, 329.6, 526.3 (repealed 1980). The purpose and effect of this regulation was to keep the cost of funds incurred by these institutions below the rate that otherwise would have been determined by the interplay of mar-

ket forces. Gorinson & Manishin, *Garn-St Germain: A Harbinger of Change*, 40 Wash. & Lee L. Rev. 1313, 1315, 1319 n.34 (1983) [cited hereinafter as "Gorinson"]; citing Carron, *The Plight of the Thrift Institutions* 5 (1981). As is often the case in regulated industries (such as airlines or trucking) where price competition is discouraged or limited, banking institutions were restricted to engaging in "non-price" competition by opening additional branches with extended hours, by offering "hidden" interest in the form of "free" gifts, or by offering a variety of services at little or no additional charge. Gorinson, *supra*, at 1319 n.35, 1320; S. Rep. No. 96-368, at 5 (1979).

Under contemporary economic conditions, including the growth of alternative savings vehicles (such as so-called money market mutual funds), the limits on interest rates made it increasingly difficult for depository institutions such as New Jersey *amici* to attract deposits. Responding to the growing crisis, Congress enacted the 1980 Act. This Act created the Depository Institutions Deregulation Committee, which was directed to phase out all price regulation of interest rates paid by national banks and other financial institutions.

As a result of this legislation and subsequent regulatory actions since its enactment in 1980, New Jersey *amici* have been participants in an increasingly vigorous market in which financial institutions compete for deposits primarily by offering substantial interest for accounts that previously received little or no interest. In response to this trend towards competition, New Jersey *amici* have effectuated a substantial unbundling of the services they offer to the public. In order to pay the high-

est possible rates of interest on various types of depository accounts, New Jersey *amici* have instituted or increased in accordance with market conditions charges for items that were previously either free or subject to nominal charges. Experience in the marketplace demonstrates that depositors in general are attracted more by the amount of interest they can earn than by artificially low fees, especially fees for items such as NSF items that are within the sole ability of the individual customer to control.[3]

B. The Effect of the Decision Below.

The California court's willingness to require the reduction of service charges to sub-competitive levels by means of *post-hoc* judicial rollbacks creates three serious disruptions in the federal bank regulatory scheme. The decision below undermines federal law mandating deregulation, threatens the safety and soundness of banks throughout the country, and materially interferes with the exclusive regulatory and visitorial powers of the Comptroller of the Currency.

The Comptroller considered all of these factors when he issued his interpretive regulation that confirmed the preemptive effect of the federal regulatory scheme. 12 C.F.R. 7.8000; 48 Fed. Reg. 54319 (1983), amended, 49 Fed. Reg. 28237 (1984). Notwithstanding the federal forum available for review of this regulation under the

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[3] In 1980, the NSF charges established by the various institutions now operated by New Jersey *amici* ranged between $5.00 and $10.00. The present range is between $15.00 and $21.50. Not only do these fees vary widely in general, but there is considerable variation even among the institutions owned by one New Jersey *amicus*, ranging from $15.00 at one of its subsidiaries to $18.00 at a second, $20.00 at a third and $21.50 at a fourth.

Administrative Procedure Act, 5 U.S.C. 702, federal review was not sought by any adversely affected party. Instead, the California Supreme Court was asked to disregard a duly promulgated federal regulation, an invitation that it eagerly accepted without concern for the nationwide ramifications of its action. This Court should reinstate the Comptroller's regulation in order to mend the three distinct breaches in the federal regulatory scheme created by the decision below.

1. The Decision Below Conflicts with Federal Deregulation Efforts

As noted above, the amount of interest a bank is willing and able to pay on its deposits necessarily depends in part on the amount of revenue it receives from service fees. In a deregulated, competitive market, it is inevitable that services will be unbundled, and that items which were previously handled at nominal or no charge will have to be priced competitively. As Crocker has amply demonstrated, the understanding of Congress, as subsequently confirmed by the Comptroller, was that interest rates could not be allowed to float to market levels unless service fees were deregulated as well, and that service fees would likely rise as unbundling occurred. See Jurisdictional Statement at 20.

The decision below upsets this balance and in effect directs that depositors who refrain from writing NSF checks are to subsidize those who utter such checks. If all service fees are forced to sub-competitive levels, resulting in a reduction in funds available to pay interest to depositors, the net effect will be that those depositors who handle their accounts carefully will suffer reduced

levels of income because of the lower fees received from those depositors who are inattentive or careless. The California court either implicitly assumed that such a cross-subsidy would not be inconsistent with the competitive market mandated by Congress, or worse, failed to recognize the import of its decision. In any event, the court failed to realize that such a cross-subsidy would be inherently unstable in a competitive market. Unlike a franchised public utility monopoly, which can price some services at below-market rates and others at super-competitive levels, a business in a competitive market that attempts such a marketing strategy will lose customers to competitive alternatives. If banks' service fees are kept artificially low, the interest rates they pay will be kept artificially low as well, and depositors will simply go elsewhere, including to non-bank savings vehicles, as they did prior to the repeal of Regulation Q.

The "cap" on NSF fees is inherently anti-competitive and inconsistent with the federal policy in favor of competition. As the Comptroller said in issuing preemptive regulations regarding Adjustable Rate Mortgages,

> The nation's depository system is gradually being transformed from a protected system of specialized lending institutions . . . into a highly competitive system of depository institutions that are increasingly competing side by side with nondepository financial intermediaries for deposits and lending opportunities. Moreover, individual savers have become increasingly sensitive to obtaining market rates of interest on their funds.

* * *

> [S]tate actions which, in effect, deprive national banks of one of their express powers . . . are incompatible with the comprehensive federal supervision of those institutions and their intended role under federal law.

46 Fed. Reg. 18934, 18942 (1981). The Comptroller's preemption was subsequently upheld as a reasonable exercise of his general regulatory powers. *Conference of State Bank Supervisors v. Lord,* 532 F. Supp. 694, 695-96 (D.D.C. 1982).

The California court unfortunately gave only casual regard to the numerous "express powers" of national banks referred to by the Comptroller. In particular, the court saw fit to dismiss as unimportant the vital right to accept deposits granted to national banks by federal law. Paragraph 7 of Section 24 of the National Bank Act, 12 U.S.C. 24, authorizes national banks to receive deposits "without qualification or limitation" and further bestows on these banks "all such incidental powers as shall be necessary to carry on the business of banking." *Franklin National Bank v. New York,* 347 U.S. 373, 376 (1954) (holding that Section 24 preempts state statute regulating bank advertising). At least since 1980, the ability of national banks to attract and retain deposits has depended principally on their ability to pay market rates of interest. The decision below would permit state court interference with the strong federal policies underlying the powers and protections granted to national banks that were enforced by this Court in *Franklin National Bank.*

The California court suggested that using the doctrine of unconscionability to depress NSF fees below the competitive market level would not interfere with the ability

of banks to pay interest and thereby attract deposits. This reasoning demonstrates a complete failure to recognize that state judicial action which depresses prices below market levels can be just as detrimental to competition as regulation that keeps prices artificially high. See Posner, *Economic Analysis of Law* 87 (2d ed. 1977) (using doctrine of unconscionability to force one price down below market level will simply force other prices up). Banks simply cannot comply both with the federal requirement that they pay market rates of interest and a state law requirement that they hold their NSF fees below market rates. This conflict compels the conclusion that the state law requirement must fall. *Hines v. Davidowitz*, 312 U.S. 52, 68 (1941).

The California court seemingly believed that its decision was not anti-competitive because banks could reduce their NSF charges freely. But competition requires that prices be free to move both up and down. To paraphrase this Court's holding in *Albrecht v. Herald Co.*, 390 U.S. 145, 152-53 (1968),

> [S]chemes to fix maximum prices, by substituting the perhaps erroneous judgment of a [court] for the forces of the competitive market, may severely intrude upon the ability of [banks] to compete and survive in that market. Competition, even in a single product, is not cast in a single mold. Maximum prices may be fixed too low for the [bank] . . . to furnish services and conveniences which consumers desire and for which they are willing to pay.

While *Albrecht* involved private restraints on competition, its reasoning is equally applicable here because Congress has affirmatively and clearly adopted a policy of competition in the financial services industry. Cali-

fornia courts should not be permitted to impose a restraint that would dampen competition for deposits and possibly lead to a cartelization of the market. *Cf. California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97, 103 (1980) (striking down California resale price maintenance scheme for wine).

2. The Decision Below Threatens Banks' Safety and Soundness

The decision below is not only anti-competitive but potentially dangerous to the financial stability of many banks that charge NSF and other service fees. If allowed to stand, the California decision will plunge all federally insured banks, including national banks, into a sea of uncertainty that will threaten the safety and soundness of the entire banking system. The millions of dollars of service fees collected by banks will be subject to *post hoc* reduction by judicial bodies.[4] This reduction would not only be imposed prospectively in the form of artificially con-

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[4] The rapid growth in interstate banking anticipated to result from this Court's decision last term in *Northeast Bancorp v. Board of Governors*, 86 L.Ed.2d 112 (No. 84-363) (1985), makes it all the more important for this Court to review the California court's decision. In the absence of preemption, national banks and bank holding companies will likely encounter a growing multitude of contradictory state requirements that will tear asunder the Congressional goal of nationwide competition. New Jersey *amici* note that several bills authorizing reciprocal interstate banking are pending in the New Jersey legislature, and that New Jersey *amici* may soon be active competitors in a number of other states. A. 3982, A. 4339, A. 4343, S. 3226, S. 3506, 201st N.J. Legislature (1984-85).

strained prices but would also lead to massive refunds that of necessity would come out of the banks' capital.[5]

Moreover, a court-enforced doctrine of unconscionability is the worst possible way to regulate NSF fees. No sort of pre-clearance is available — a bank must simply set its prices and then hope that a court will not find them to be "excessive". Nor is the court's standard of "cost" plus a "reasonable" profit one to which banks can adhere without significant risk. There are no uniform cost allocation manuals or methodologies in use in the banking industry that produce the one "right" price for NSF fees. Yet the decision below forces a bank to choose a price at its peril. If it happens to choose the "wrong" price, meaning one not in accordance with a subsequent judicial decision, it may be forced to refund the difference. The decision below is surely capable of generating in every state, including New Jersey, considerable litigation in which plaintiffs will seek to impose refund liabilites on banks.

3. The Decision Below Interferes with the Comptroller's Responsibilities

The California court further assumed that its newly announced doctrine of "unconscionability" could be applied against national banks without interfering with the exclusive supervisory and regulatory powers of the Comp-

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[5] Even though depositors are the principal beneficiary of higher service fees, since the fees enable banks to pay higher rates of interest on deposits, it would clearly be impossible to require depositors to turn over a portion of the interest they have earned as a subsidy to those who have written bad checks. Prospectively, of course, this cross-subsidy from depositors who do not write bad checks to those who do is precisely what the California decision would require.

troller. This assumption is simply not true. As explained by Crocker, Jurisdictional Statement at 14-17, the Comptroller's broad supervisory powers and its exclusive visitorial powers work together to make service fees such as NSF charges the subject of Comptroller regulation that may not be repriced as a result of state judicial proceedings. Such repricing would necessarily involve a probing scrutiny of a bank's books and records that would conflict with the Comptroller's responsibilities. 12 U.S.C. 484; 12 C.F.R. 7.6025. Even if one were to assume for the sake of argument that New Jersey substantive law prohibits banks from charging competitively determined fees that happen to be in excess of their costs — a question that is not presented and need not be reached here — enforcement of that substantive law must be left to federal regulators, who would have the power to recommend repricing on a prospective basis without necessarily ordering massive refunds that would undermine the safety and soundness of the affected institutions. See *Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256, 1260 (9th Cir.), aff'd per mem., 445 U.S. 921 (1979) (California anti-redlining law must be enforced, if at all, by Federal Home Loan Bank Board); *National State Bank v. Long*, 630 F.2d 981, 988-89 (3d Cir. 1980) (New Jersey anti-redlining law cannot be enforced by State Commissioner but only by Comptroller).

Significant interference with the Comptroller's responsibilities will result from the California court's decision. For example, the effect of the California ruling will be to force NSF fees down to artificially low levels and to remove the principal deterrent against writing NSF checks. Yet the Comptroller has specifically directed the banks

under his supervision to consider the deterrent factor when they establish NSF fees. 12 C.F.R. 7.8000; 48 Fed. Reg. 54319 (1983). Thus, the decision below in effect compels banks to disregard the instruction of the Comptroller. It directly conflicts with the national goal of reducing the number of NSF checks, recently estimated at approximately 400 million each year. *American Banker*, May 15, 1984, at 2.[6]

In sum, the decision below leaves New Jersey *amici* and all other national banks in every state with irreconcilable obligations under federal and state law. Congress has determined that the market in which all depository institutions compete should be deregulated so that interest rates and related fees can float to their natural market levels. The Comptroller has directed national banks in particular to participate vigorously in the deregulated marketplace. This federal determination has been invalidated in California on reasoning that is equally applicable in New Jersey and throughout the nation. New Jersey *amici* have been and expect to continue to be vigorous competitors in the newly deregulated market, but they cannot compete if their market-determined service fees are subjected to periodic *post hoc* challenge and downward adjustment and refund by state courts. If service fees are depressed to below-market levels, either interest rates or bank earnings will be depressed as well. In either event, as explained here and in Crocker's Jurisdictional Statement, the safety and the soundness of the banking system may be put into play.

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[6] Higher NSF fees unquestionably serve as a deterrent to the writing of such checks. When Girard National Bank in Philadelphia increased its fee to $30 several years ago, the number of NSF checks processed by it was reduced by 35%. *American Banker*, May 19, 1981, at 4.

CONCLUSION

For the foregoing reasons, as well as the reasons expressed in Crocker's Jurisdictional Statement, this Court should note probable jurisdiction and reverse the decision of the California Supreme Court.

Respectfully submitted,

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No. 85-1035

In the Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,

Appellant,

v.

PAUL PERDUE,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF CALIFORNIA

BRIEF OF *AMICUS CURIAE* FIRST INTERSTATE BANK OF OREGON, N.A., IN SUPPORT OF APPELLANT CROCKER NATIONAL BANK'S JURISDICTIONAL STATEMENT

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TABLE OF CONTENTS

Page

INTERESTS OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 3

ARGUMENT 4

I THE ISSUES IN THIS CASE ARE OF THE UTMOST NATIONAL SIGNIFICANCE 6

A. The Decision Below Severely Alters the Character of the Banking Industry 6

B. The California Supreme Court's View Heavily Burdens National Banks 7

C. There Are Conflicting Opinions on the Preemption Issue Among the States 9

D. This Case Involves a Substantial, Undecided Federal Question 10

II THE SUPREMACY CLAUSE BARS STATE LIMITS ON NATIONAL BANK NSF CHARGES BECAUSE SUCH RESTRICTIONS STAND AS AN OBSTACLE TO THE ACCOMPLISHMENT OF THE FULL PURPOSES AND OBJECTIVES OF CONGRESS 11

A. State Restriction of NSF Charges Stands as an Obstacle to the Accomplishment of the Full Purposes and Objectives of Congress 11

B. 12 C.F.R. § 7.8000 Directly Conflicts with State Limits on NSF Charges 14

TABLE OF CONTENTS (Cont.)

Page

III THE CALIFORNIA DECISION VIOLATES THE SUPREMACY CLAUSE BECAUSE CONGRESS HAS OCCUPIED THE RELEVANT FIELD 16

CONCLUSION 18

TABLE OF AUTHORITIES

CASES	PAGE
City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973)	17
Daggs v. Phoenix National Bank, 177 U.S. 549 (1900)	13
Easton v. Iowa, 188 U.S. 200 (1903)	17
Fidelity Federal Sav. & Loan Ass'n. v. De La Cuesta, 458 U.S. 141 (1982)	5, 10
First Nat. Bank of Logan v. Walker Bank & T. Co., 385 U.S. 252 (1966)	10
First Nat. Bank of San Jose v. State of California, 262 U.S. 366 (1923)	17
Franklin Nat. Bank of Franklin Square v. People, 347 U.S. 373 (1954)	10, 17
Hiatt v. San Francisco National Bank, 361 F.2d 504 (9th Cir.), *cert. denied*, 385 U.S. 948 (1966)	13
Hoffman v. Security Pac. Nat. Bank, 121 Cal. App. 3d 964, 176 Cal. Rptr. 14 (1981)	13
Jacobs v. Citibank, N.A., 61 N.Y.2d 869, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (1984)	9, 15
McCulloch v. State of Maryland, 17 U.S. (4 Wheat.) 316 (1819)	4

CASES (Cont.) Page

Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978) 5

Silkwood v. Kerr-McGee Corp., 464 U.S. 238, 104 S. Ct. 615 (1984) 5, 16

Tolbert, et al. v. First National Bank of Oregon, No. A8004-02328 2

CONSTITUTION

U.S. Const. Art. VI, cl. 2 5

FEDERAL STATUTES AND REGULATIONS

12 U.S.C. § 24 (Seventh) 11

12 U.S.C. § 85 13

12 C.F.R. § 7.2 15

12 C.F.R. § 7.8000 ..... 14, 15, 17

PUBLIC LAWS

Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 12

Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 12

OTHER AUTHORITIES

Brady on Bank Checks § 17.1 (5th ed. 1979) 13

Comptroller's Handbook for National Bank Examiners § 301.1 (1977) 14

INDEX TO APPENDIX

Appendix Designation	Description	Page
A	Letter, James J. Saxon to Mr. Chairman, November 5, 1963	1a
B	12 C.F.R. § 7.2 (1962)	3a
C	12 C.F.R. § 7.8000 (1971)	6a

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INTERESTS OF AMICUS CURIAE

Appellant Crocker National Bank filed a jurisdictional statement with this Court, seeking review of a California Supreme Court decision. That decision rejected federal preemption and set the stage for state court regulation of national bank charges for checking account services. The particular charge at issue is the "NSF charge" that is levied when a customer over-

draws the checking account. Because of the importance of the questions involved in the appeal, First Interstate Bank of Oregon, N.A. ("First Interstate"), through its counsel, requested and received consent from both parties to the proceedings below to submit this brief in support of Crocker National Bank's jurisdictional statement.

Amicus First Interstate is a national bank. It provides, among many other services, checking accounts to customers throughout the State of Oregon. As a national bank, First Interstate is, of course, subject to federal banking laws and regulations.

In 1980, three plaintiffs filed suit in the Circuit Court for Multnomah County, Oregon, on behalf of a class of individual checking account customers estimated to number over 200,000. (*Tolbert, et al.* v. *First National Bank of Oregon* [now known as First Interstate], No. A8004-02328.)[1] This suit challenged First Interstate's $6 NSF charge on a variety of state common-law and statutory theories. The state trial court certified a class and rejected First Interstate's federal preemption argument. The case proceeded to trial in March 1985. Plaintiffs' theory at trial was that the

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[1] Four other cases challenging bank NSF charges were filed in Oregon state courts at about the same time as *Tolbert*. One was decided in the bank's favor on summary judgment and is now before the Oregon Court of Appeals; one issue there involves federal preemption. The three additional cases remain dormant, pending the outcome of *Tolbert* and the other Oregon case now on appeal.

NSF charge represented an invalid liquidated damage provision, or "penalty", instead of a service charge, such that the NSF charge must approximate the bank's processing cost. Plaintiffs asked for $12 million in damages, plus fees and costs, under this claim. After pretrial and trial proceedings totaling over a month, the jury returned a verdict in favor of First Interstate. Plaintiffs have appealed, and the appeal is pending before the Oregon Court of Appeals. Federal preemption is one of the issues on appeal.

A decision from this Court would resolve a key question now before the Oregon appellate courts. Indeed, a decision in favor of Crocker National Bank would terminate the controversy in *Tolbert*, to which this *amicus* is a party, and in the several other related Oregon cases. First Interstate, then, has a direct interest in having this Court correct the erroneous proposition that a state court may modify the price at which a national bank offers demand deposit accounts to the public.

SUMMARY OF ARGUMENT

This Court should exercise jurisdiction over this appeal because fundamental, undecided Supremacy Clause issues are at stake. In the absence of such exercise, the California decision will be used to effect improper and inconsistent state regulation of national banks. The entire pricing structure of national bank services in the newly competitive, deregulated market is affected.

Not only is the California decision far-reaching, it also is wrong. Conflict preemption exists because there is an extensive body of federal statutes and regulations opposed to the exercise of state authority sought by the plaintiff below and allowed by the decision at issue. In addition, field preemption exists because federal law already has occupied the field the state court is trying to invade: there is federal law on the issues of how NSF charges are to be set and what is a proper amount.

ARGUMENT

In one of its earliest cases, this Court saw the need to maintain the autonomy and stability of national banks. Chief Justice Marshall, writing for a unanimous court in *McCulloch* v. *State of Maryland*, 17 U.S. (4 Wheat.) 316 (1819), recognized the concept of preemption and confirmed that a state law may not "retard, impede, burden, or . . . control" federal enactments relating to the operations of national banks. 17 U.S. at 436.

A strong, stable national banking system is just as critical now as it was 160 years ago. The recent bank failures, the aggressive position of the FDIC, and the dependence of our entire economy on a sound national bank system all are factors that demonstrate the vital importance of the federal banking laws in our country today.

A state may, of course, regulate national banks. A state may not, however, interfere with a national

bank or supersede Congress's plans; such action is preempted under the Supremacy Clause.[2]

There are three methods by which federal preemption of state authority may occur.[3] The three methods are express preemption, implied preemption, and preemption by virtue of conflict between state and federal regulation. The second and third apply here. A state exercise of authority that conflicts with the network of federal banking laws and regulations, or impinges on an area of national bank law reserved by Congress, is unconstitutional under the Supremacy Clause.

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[2] "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. Art. VI, cl. 2.

[3] *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151 (1978); *Fidelity Federal Sav. & Loan Ass'n.* v. *De La Cuesta*, 458 U.S. 141 (1982); *Silkwood* v. *Kerr-McGee Corp.*, 464 U.S. 238, 104 S. Ct. 615, 621 (1984).

I

THE ISSUES IN THIS CASE ARE OF THE UTMOST NATIONAL SIGNIFICANCE.

A. The Decision Below Severely Alters the Character of the Banking Industry.

Federal banking laws, regulations, and policies provide for market pricing of national bank services. The California Supreme Court's ruling, if followed in other jurisdictions, will preclude national banks from using this uniformly market-driven system of pricing NSF services, and the ruling may be extended to preclude market pricing of all bank services. Thus, this case has the potential to work a radical transformation of one of the most basic concepts of national banking.

Suppose that, instead of a common-law theory, this Court were considering a state statute that established local boards to regulate bank pricing. Suppose further that these boards would act like public utility commissions; they would make rules to define "costs", require banks to submit economic evidence, and appoint industry experts to set tariffs. Those tariffs would, in our example, cover prices related to checking account services. There is no question that the Supremacy Clause would preclude application of this state regulatory system to national banks.

The decision below has done essentially the same thing. While the jury in the First Interstate case found as a factual matter that the NSF charge was a service charge, so that the market properly set the

price, the California Supreme Court has held the opposite. Under its holding, the market mechanism is forbidden to fix the NSF charge. Instead, in every instance a national bank must submit to a quasi-rate hearing before a lay jury, who will decide after the fact, and without standard guidance as to allowable accounting methods, whether the national bank's price was properly related to its costs. This result will be nothing short of revolutionary nationwide.

B. The California Supreme Court's View Heavily Burdens National Banks.

The impact upon this *amicus* of the issue presented here illustrates its enormous practical — as well as theoretical — importance to the national banking system. The First Interstate NSF case shows that the *burden*, in cost and time, of the assertion of a state-law claim is immense. Discovery spanned a period of over four years; the jury trial lasted over three weeks. Plaintiffs now are challenging First Interstate's victory in the Oregon appellate courts. This process will consume substantial additional resources unless this Court steps in to remedy the error of the California Supreme Court and of other state courts that may rely upon the decision below.

Nor should First Interstate's verdict cause this Court to be sanguine. First, of course, a national bank should be required neither to bow to state regulation in this area nor to pay the high price of obtaining a favorable verdict.

Second, there is no analytic distinction between this

service — processing an overdrawn check and considering whether to extend credit to the customer — and other bank services. The evidence in the First Interstate case was that the bank performs about 200 separate services. Other plaintiffs may sue First Interstate or other national banks in an attempt to learn about other bank costs and to limit other service fees.

Third, jury verdicts are unlikely to remain consistent from one national bank to the next. For instance, expert testimony in First Interstate's trial pegged the "cost" of an NSF check all the way from 92c to $7.33 during the relevant period, depending on what elements were included. Among the many vigorously disputed elements of costs, for example, was the loss resulting from customers' failure to repay overdrafts. In the event juries reach the cost-price relationship question, they can be expected to give widely varied answers as to each element of cost. Just in Oregon, the five pending cases could, and probably would, yield five different ways of determining "cost." The necessary result of the California decision will be *non-uniform regulation* of national banks.

Expert testimony in the First Interstate trial highlights the effects of attempting to regulate national bank pricing. Competition in the market for demand deposit accounts has increased dramatically since deregulation began in 1980. In Oregon, competition among banks, and between banks and other types of financial institutions, is now vigorous. An artificial (lower than market) price for NSF checks would place

First Interstate in a more difficult market position. Because a low price would encourage a disaportionate number of NSF checks, merchants would become unwilling to accept First Interstate checks. This in turn, would impair the bank's ability to attract and retain customers and, thus, to remain financially sound.

C. There Are Conflicting Opinions on the Preemption Issue Among the States.

The California Supreme Court found no preemption. The trial court in Oregon similarly rejected federal preemption arguments, although the issue now is pending on appeal.

In contrast, New York's highest court has suggested (albeit not squarely held) that federal regulation preempts state control of NSF charges. In *Jacobs* v. *Citibank, N.A.*, 61 N.Y.2d 869, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (1984), the court decided that summary judgment on behalf of the bank was proper. There, as in the present case and the *Tolbert* case involving this *amicus*, the plaintiffs challenged the amount of the bank's NSF charge under state law theories. The court wrote:

> "... To grant the relief requested by plaintiffs would be to impose a limit on the amount Federally chartered banks can charge for processing overdrafts. This is a task more properly left to the Comptroller of the currency who has decided that '[a]ll charges to customers should be arrived at by each bank on a competitive basis'. (12 CFR 7.8000[a].)" 474 N.Y.S.2d at 465.

New York's approach, then, conflicts with the determination of the California Supreme Court below.

D. This Case Involves a Substantial, Undecided Federal Question.

The issue presented here is a substantial federal question under the Supremacy Clause. Its importance is demonstrated in the remainder of this brief and in the Jurisdictional Statement of Crocker National Bank. This Court has never answered the question, nor even a very closely analogous one.

Indeed, it has been many years since this Court considered a federal preemption issue regarding banks, *see Franklin Nat. Bank of Franklin Square* v. *People*, 347 U.S. 373 (1954), or discussed the history and philosophy of the National Banking Act. *see First Nat. Bank of Logan* v. *Walker Bank & T. Co.*, 385 U.S. 252 (1966). In the interim, with deregulation, the national banking laws have undergone significant change. Nor have market conditions for national banks remained static in the past 20 years. Comptroller's regulations have developed, and this Court's interpretation of preemption has evolved, *see Fidelity Federal Sav. & Loan Ass'n* v. *De La Cuesta*, 458 U.S. 141 (1982). In view of this changing legal, regulatory, and economic environment, guidance from this Court is essential for national banks.

II

THE SUPREMACY CLAUSE BARS STATE LIMITS ON NATIONAL BANK NSF CHARGES BECAUSE SUCH RESTRICTIONS STAND AS AN OBSTACLE TO THE ACCOMPLISHMENT OF THE FULL PURPOSES AND OBJECTIVES OF CONGRESS.

A. State Restriction of NSF Charges Stands as an Obstacle to the Accomplishment of the Full Purposes and Objectives of Congress.

Conflict preemption exists whenever state law presents an obstacle to the accomplishment of the full purposes and objectives of Congress. There is a comprehensive federal statutory scheme regarding banking. A state limit on NSF charges would present an obstacle to many of the federal objectives in this statutory scheme.

Several of the Congressional objectives that would be impeded are discussed in the Jurisdictional Statement of Crocker National Bank:

(1) The National Banking Act empowers national banks to receive deposits and grants them all necessary incidental powers. 12 U.S.C. § 24 (Seventh). State restrictions on actions related to the deposit-taking power are an obstacle to complete attainment of this goal.

(2) In 1980 [4] and 1982, [5] Congress phased out all limits on the rate of interest a federally insured bank could give and required them to pay market rates for deposits. In doing so, Congress expressly recognized that deregulation would require financial institutions to increase service charges on deposits, as well as interest rates on loans, in order to afford to pay market rates on deposits. State limits on NSF charges impede this policy.

(3) The National Banking Act and supporting regulations have established an intricate system to ensure the safety and soundness of national banks. One element Congress carefully balanced is service charges. If successful, the present suit and others like it would alter the balance and thus interfere with Congressional objectives.

(4) This lawsuit and similar ones interfere with the Comptroller's exclusive visitorial authority over national banks, because national bank records would be subject to inspection to see if NSF charges are "cost justified."

An additional Congressional objective impeded by this suit (and the similar ones filed elsewhere) is the general federal power to control national bank interest

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[4] Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132; 12 U.S.C. § 3503.

[5] Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469.

rates. For over 100 years, federal law has set interest rate ceilings for national banks. The ceiling set under federal law is usually the maximum rate allowed general lenders under the state law of the state where the national bank is located. *See* 12 U.S.C. § 85; *Hiatt* v. *San Francisco National Bank*, 361 F.2d 504 (9th Cir.), *cert. denied*, 385 U.S. 948 (1966); *Daggs* v. *Phoenix National Bank*, 177 U.S. 549 (1900).

Interest is the charge banks make for their principal service, lending money. Banks supplement their income from lending by providing associated services, such as checking accounts, for which other charges are made. If Congress alone may regulate the charge for lending money, it is implicit that states may not regulate national banks' similar charges. This is particularly true with respect to charges for processing NSF checks, because many authorities consider such checks to be unauthorized loan applications. *See Brady on Bank Checks* § 17.1 at p. 17-2 (5th ed. 1979) ("Overdrafts are said to be in the nature of loans not made in a creditable way . . ."); *Hoffman* v. *Security Pac. Nat. Bank*, 121 Cal. App. 3d 964, 176 Cal. Rptr. 14, 16 (1981) ("[S]tatutes governing the obligations of banks and their depositors, which are incorporated into and become part of the contract between a bank and its depositors . . ., treat an overdraft as an application for advance credit rather than as a breach of an express or implied covenant."). Thus, state regulation of NSF charges interferes with Congress's intent to regulate interest charged by national banks.

To summarize, the relief the plaintiff sought would require a state court to evaluate the workings of a national bank and make a determination as to the bank's costs and profitability. The plaintiff has asked a state court to pierce the very heart of a national bank and weigh the appropriateness of the means the bank uses to sustain itself. Such action impermissibly interferes with the federal structure that Congress established for the sanctity and soundness of national banks.

B. 12 C.F.R. § 7.8000 Directly Conflicts with State Limits on NSF Charges.

Even if the federal statutory scheme described above did not exist, the plaintiff's claim is preempted because of actual conflict between the recovery sought and 12 C.F.R. § 7.8000.[6] The Comptroller's ruling directs that a national bank set service charges using its business judgment. Under the rule, a national bank may consider profit motive and deterrence of frequent NSF check writing. The most recent statement of federal policy, set out in Crocker National Bank's Jurisdictional Statement and Appendix, comports with federal policy for over 20 years that national banks may consider noncost or market factors in setting service charges.

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[6] The *Comptroller's Handbook for National Bank Examiners* similarly recognizes that a national bank might levy a non-cost-based charge for NSF checks. *See, e.g., id.* at § 301.1 at 2 (1977) (overdraft charges should discourage frequent writing of NSF checks).

On March 5, 1962, then-Comptroller James J. Saxon issued an interpretive ruling regarding service charges — 12 C.F.R. § 7.2 (Appendix B). This ruling directed national banks to set their fees independently and not collusively. The regulation also specified *how* a national bank was to set its prices when conducting its independent review. It directed a bank to consider *both* "the individual bank's costs *and its competitive position.*" (Emphasis added.) In other words, the Comptroller expressly authorized national banks to consider market factors when setting their service charges.

Comptroller Saxon's 1962 ruling was reaffirmed in 1971 by Comptroller William B. Camp. At that time, the Comptroller performed a comprehensive reevaluation of various policies relating to national banks. Many policies were revised or deleted. Section 7.2, however, was readopted as § 7.8000 (Appendix C); the Comptroller reaffirmed in § 7.8000 the federal commitment to national bank service charges set on a "competitive" basis. New York's highest court recently recognized this feature of the 1971 ruling. In February 1984, the New York Court of Appeals relied on this 1971 ruling in rejecting plaintiffs' NSF challenge. *See Jacobs* v. *Citibank*, N.A., 61 N.Y.2d 869, 474 N.Y.S.2d 464, 462 N.E.2d 1182 (1984) (The task of deciding what NSF charges are appropriate is "more properly left to the Comptroller of the currency who has decided that '[a]ll charges to customers should be arrived at by each bank on a competitive basis'." 474 N.Y.S.2d at 465 (quoting 12 C.F.R. § 7.8000).).

Contemporaneous sources confirm two important points. First, the Comptroller wanted market factors, not just cost, to govern national bank service charges. Second, the Comptroller consciously included NSF charges among the matters within the purview of federal regulation. *See* text of November 5, 1963 letter of Comptroller Saxon (Appendix A).

In short, this plaintiff's lawsuit and others like it conflict with the long-standing federal policy to use a noncost, market approach to national bank service charges, including NSF charges. This long-standing policy provides an independent basis for preemption.

III

THE CALIFORNIA DECISION VIOLATES THE SUPREMACY CLAUSE BECAUSE CONGRESS HAS OCCUPIED THE RELEVANT FIELD.

The resolution of field preemption cases often turns on how the field is defined. *See Silkwood* v. *Kerr-McGee Corp.*, 464 U.S. 238 (1984) (majority found no preemption because Congress did not intend to disturb state remedies; dissent defined the field differently and argued that there was preemption because Con-

gress did not specifically exempt punitive damages from preemption). A "field" need not be very broad. *See City of Burbank* v. *Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973) (regulation of noise from aircraft was relevant field). In this case, Crocker National Bank should prevail regardless of how the field is defined.

If the "field" is defined narrowly, this Court must ask, "Has federal law occupied the field of the appropriate amount for NSF charges?" Because the answer to this question is an unequivocal "yes," *see* 12 C.F.R. § 7.8000, field preemption exists.

Using a broader definition, the Court should ask, "Has federal law occupied the field of the incidental acts necessary to a national bank's power to receive deposits?" The answer to this question, too, is an unequivocal "yes" under the holding of *Franklin Nat. Bank of Franklin Square* v. *People*, 347 U.S. 373, 378 (1954) (national bank could advertise as a "savings" bank in contravention of New York state law; no indication that Congress intended this phase of national banking to be subject to local restrictions). *See also Easton* v. *Iowa*, 188 U.S. 220, 229 (1903) (national banks exempt from state conditions on receipt of deposits); *First Nat. Bank of San Jose* v. *State of California*, 262 U.S. 366, 369 (1923) (state escheat law preempted by deposit-taking function of national banks). Thus, field preemption exists regardless of how the field is described.

CONCLUSION

This *amicus*, like other national banks, now faces a fundamental conflict between federal and state law. Federal laws, regulations, and policies mandate market pricing, while state courts, including the courts below, are attempting to alter and limit the market pricing mechanism for bank services.

For the reasons stated above, *amicus curiae* First Interstate Bank of Oregon, N.A., urges this Court to consider the merits of this case and either (1) set the matter for oral argument or (2) reverse the California Supreme Court decision summarily.

Respectfully submitted,

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of Oregon, N.A.

**Counsel of Record*

January 14, 1986

APPENDIX A

Gwin-Examiner
November 5, 1963

Dear Mr. Chairman:

This Office takes the position in regard to bank service charges that this is a matter to be governed by banking judgment as controlled by competitive factors in the arena in which the banks operate. If a particular bank imposes service charges that are too high, a rival bank would be able to take away a great deal of its business by offering a lower rate. Inasmuch as our society is grounded on the principle of free competition, strong competitors rather than government regulation in the local banking picture are the surest safeguards against arbitrary and unreasonable charges by an individual institution. Only when the competitive arena is a closed market and dominated by one or a few organizations does government regulation become the only answer to improper service charges and the like by banks.

The same argument would also apply to unreasonable penalties for checks drawn without sufficient funds even though this might be a more rarely used and less well-known policy of the bank. If depositors are treated unfairly in this matter at an institution, as this becomes known, more and more of the banking public will begin to deal with competitors.

This Office, therefore, does not attempt to regulate the charges that National Banks impose on their cus-

tomers. If, of course, in this area a case of gross abuse of discretion akin to fraud or the like were to be brought to the attention of our examiners, this Office would take appropriate regulatory action. In regard to Mr. Kimmel's letter, it would be difficult to make any particular comment without knowing and having proof of all the facts.

Sincerely,

/S/ JAMES J. SAXON

JAMES J. SAXON
Comptroller of the Currency

HONORABLE DENTE B. FASCELL
Chairman, Legal and Monetary Affairs Subcommittee of the
Committee on Government Operations
House of Representatives
Washington, D.C.

Enclosure

TGraham: 1m 11/4/63

APPENDIX B

Title 12 — BANKS AND BANKING

Chapter 1 — Bureau of the Comptroller of the Currency, Department of the Treasury

PART 7 — INTERPRETATIONS

National Banks; Service Charges

Part 7, Chapter I, Title 12, of the Code of Federal Regulations of the United States of America is hereby amended by adding a new § 7.2 as follows:

§ 7.2 *National banks; service charges.*

The Comptroller of the Currency has issued formal instructions concerning the service charges of banks as indicated in the following letter addressed to the presidents of all national banks:

To the presidents of all national banks:

So that there may be no misunderstanding with respect to the policy of this Office concerning the service charges of banks, I am issuing these formal instructions to all national banks.

Agreements, arrangements, undertakings, understandings, etc., among banks, through clearing houses or otherwise, concerning service charges are not permissible in any form. It is the responsibility of the

Board of Directors of each national bank to terminate promptly any of these practices which it may now be following.

Wherever a national bank has been involved in any of the practices cited, it should now review its scale of service charges independently of any other bank, and take appropriate corporate action to re-establish a scale of service charges independent of any relationships with any other bank. In taking this action, it is appropriate to make such changes in the scale of service charges as are deemed necessary or desirable in the light of the individual bank's costs and competitive position. This review and re-establishment of the scale of service charges should be undertaken, even though there may have been no overt or implicit agreement, wherever there have been discussions of such charges among banks or their officers, either independently or in group meetings, or where the scale of service charges was adopted with knowledge of prospective adoption of similar charges by competitor banks.

It is recognized that identical charges for identical services may occur where there are no agreements or understandings among banks. Nevertheless, wherever this occurs, each national bank must be prepared to demonstrate conclusively that its scale of service charges was decided unilaterally, and not on the basis of any agreement or understanding, or even of discussion, among banks or their officers.

Our examiners have been instructed to explore,

regularly and in detail, the methods by which the existing scale of service charges was determined by each national bank. At the time of the next examination of your bank, inquiry shall be made to determine whether appropriate action has been taken, where necessary, to conform to these instructions.

(R.S. 5240; 12 U.S.C. 1, 481)

Dated: March 5, 1962.

[SEAL]

JAMES J. SAXON
Comptroller of the Currency

[F.R. Doc. 62-2336; Filed, Mar. 8, 1962; 8:49 a.m.]

APPENDIX C

§ 7.8000 *Charges by banks.*

All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or even discussion among banks or their officers.

Dated: August 20, 1971

[SEAL]

WILLIAM B. CAMP
Comptroller of the Currency

[F.R. Doc. 71-12412; Filed, 8-25-71; 8:45 a.m.]

BEST AVAILABLE COPY

No. 85-1035

Supreme Court, U.S.
FILED
JAN 15 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,

Appellant,

v.

PAUL PERDUE,

Appellee.

On Appeal from the Supreme Court of the State of California

BRIEF OF THE AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE APPELLANT

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18 pp

QUESTION PRESENTED FOR REVIEW

Whether a complaint alleging that service charges are "unconscionable," based upon state law, states a valid claim upon which relief can be granted against a national bank, which is subject to the preemptive rules and regulations of the Comptroller of the Currency.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED FOR REVIEW	i
TABLE OF AUTHORITIES	iii
INTEREST OF THE AMICUS CURIAE	2
SUMMARY OF THE ARGUMENT	7
ARGUMENT	7
I. Background Of The Case	7
II. State Law, As Construed By The California Supreme Court, Is Preempted By Lawful Regulations Of The Comptroller Of The Currency	9
CONCLUSION	13

TABLE OF AUTHORITIES

CASES: Page

American Bank & Trust Co. v. Dallas County, 103 S. Ct. 3369 (1983) 9

FAIC Securities, Inc. v. United States, 768 F.2d 352 (D.C. Cir. 1985) 3

Fidelity Federal Savings and Loan Association v. de la Cuesta, 458 U.S. 141 (1982) 10, 12, 13

First National Bank v. California, 262 U.S. 366 (1923) 11

Florida Lime and Avocado Growers, Inc. v. Paul, 373 U.S. 132 11

Franklin National Bank v. New York, 347 U.S. 373 (1954) 11

Independent Bankers Association of America v. Heimann, 627 F.2d 486 (D.C. Cir. 1980) 3

Iowa-Des Moines National Bank v. Bennett, 284 U.S. 239 (1931) 9

McCullough v. Maryland, 4 Wheat. (17 U.S.) 316 (1819) 9

Northeast Bancorp v. Board of Governors of the Federal Reserve System, 105 S. Ct. 2545 (1985) 4

Owensboro National Bank v. City of Owensboro, 173 U.S. 664 (1899) 9

Porter v. Rushing, 65 F. Supp. 759 (W.D. Ark. 1946). 8

United States v. Shimer, 367 U.S. 374 (1961) 12

STATUTES:

Del. Code Ann. Tit. 5, §§ 801-808 3

Pub. L. 96-221 (March 1980) 4

12 U.S.C. § 1 9

12 U.S.C. § 24 9

12 U.S.C. § 484(B) 11

12 U.S.C. § 1818 6

Table of Authorities Continued

	Page
REGULATIONS:	
12 C.F.R. Part 217 (1979)	4
12 C.F.R. § 7.8000 (1982)	10
12 C.F.R. § 7.8000(b) (1985)	13
12 C.F.R. § 7.8000(c) (1985)	10
36 Fed. Reg. 17,000 (1971)	10
MISCELLANEOUS:	
K. Davis, *Administrative Law* § 4.04 at 247 (1st ed. 1958)	3
Bank Service Charges and Fees: Their Impact on Consumers. A Study of the Board of Governors of the Federal Reserve System at the Request of the Consumer Advisory Council	6

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BRIEF OF THE AMERICAN BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE APPELLANT

The American Bankers Association respectfully submits this brief as amicus curiae, with the consent of the parties, in order to urge this Court to note probable jurisdiction in the above-entitled appeal. In the decision from which the appeal is taken, the Supreme Court of the State of California determined that a complaint states a valid cause of action where it alleges that a bank's service charges are "uncon-

scionable." As much as we disagree with that conclusion, we recognize the paramount *authority* of the Supreme Court of California to determine that question as a matter of state law. Nevertheless, a substantial federal question is presented and should be resolved by this Court because the defendant in the case below is a *national* bank, to which *state* law may not be applied in the face of a contrary conclusion by the Comptroller of the Currency.

INTEREST OF THE AMICUS CURIAE

The American Bankers Association is the largest national trade association of the commercial banking industry in the United States, having as members approximately 12,000 commercial banks, located in each of the fifty states and the District of Columbia. ABA membership includes banks chartered by the Comptroller of the Currency ("national banks") and banks chartered by the states in which they are located ("state banks"). Crocker National Bank, the appellant in this case, is a national bank member of the American Bankers Association.

The Association frequently appears in litigation, either as a party or as amicus curiae, in order to represent the interests of the membership on issues of great importance to the banking industry. ABA is concerned with any decision, whether legislative, administrative or judicial, which impedes the ability of our members, or any of them, to serve their customers, to compete on equal grounds amongst themselves or with other industries and institutions, or to make legitimate business judgments on matters such as the pricing of services at issue in this case.

Historically, the banking industry has been perhaps the most highly regulated of all industries in the United States. K. Davis, *Administrative* Law § 4.04 at 247 (1st ed. 1958). Banking regulation in the not too distant past has been restrictive of the ability of banks to engage in whatever business and in whatever manner good business judgment might dictate, but at the same time it had been protective as well. It immunized the industry from competition by nonbanks and fixed narrow limits for competition even within the industry.

That has all changed and is in the process of changing still further. In the past, for example, banking was a strictly local business. Banks in many states could not even establish branch offices; in other states, branch banking was limited to home counties of a bank or to the home county and contiguous counties; in some states, branching was permitted state-wide. The operation of banking organizations across state lines was almost unheard of. Bank depositors and borrowers now have simple and practical alternatives to dealing with a local banking organization. Loan production offices of banks operate across state lines. *Independent Bankers Association of America v. Heimann*, 627 F.2d 486 (D.C. Cir. 1980); so-called "money brokers" are happy to search out the financial institutions, wherever located, at which the best rate of return is offered and to "place" deposits in those institutions for customers nationwide. *FAIC Securities, Inc. v. United States*, 768 F.2d 352 (D.C. Cir. 1985). State laws in many jurisdictions have been amended to invite the establishment of banking offices in the state by out of state institutions. *See, e.g.*, Del. Code Ann. Tit. 5, §§ 801-808 (1985). Other states

have adopted regional banking laws which permit interstate acquisitions or mergers of bank holding companies within a specified geographic sector of the country. *See Northeast Bancorp v. Board of Governors of the Federal Reserve System*, 105 S. Ct. 2545 (1985). A variety of electronic funds transfer methods and devices permit instantaneous financial transactions between banks and far away customers. Thus, there is little reason any longer for a sophisticated California customer to transact business with a California bank if the customer can get a better deal from a New York bank or a Mississippi bank. Conversely, New York and Mississippi customers are entirely free to deal with California banks if those banks better serve their interests.

Not so long ago, there were strict limits on the interest that federally insured banks could pay to their depositors. *See* Regulation Q, 12 C.F.R. Part 217 (1979). The regulations kept the banks' cost of funds relatively low and did not allow realistic "price" competition in this respect among banks. That, too, has changed. Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, in March 1980. Title II of that Act created the Depository Institutions Deregulation Committee and directed that Committee to phase out "limitations on the maximum rates of interest and dividends which may be paid on deposits and accounts" (Section 204(a)). That directive was carried out and will be completed in less than three months. Banks may now offer "market rates" of interest to their customers on virtually all deposit accounts other than demand deposits.

During the phase-out period of interest rate limitations, commercial banks experienced a narrowing of the "spread" between their cost of funds, i.e., interest rate paid on deposits and the income received from the interest charged on loans.

Total interest *income* for the banking industry increased from 7.3% of average assets to 10.32% between 1978 and 1984. During the same time period, total interest *expense* of the industry increased from 4.17% to 6.97%. Loan loss provision increased, 1978-1984, from .25% to .55%. The result was that the net interest income for the banking industry—the "spread"—declined slightly from 2.88% of average assets to 2.80%. At the same time, non-interest income (which includes, but is not limited to, fee income) increased steadily from .69% to 1.09% of average assets. Non-interest expenses also increased at an even greater rate, from 2.5% in 1978 to 3.04% in 1984, resulting in a decline in net income for the banking industry over that six year period from .76% of average assets to .65%[1] A 1974 study by the Federal Reserve pointed out that between 1979 and 1983, income to banks from service charges on personal checking accounts increased anywhere from 42% to 100% depending upon bank size, but that at the same time the expenses to the banks increased even more rapidly. The net effect was that the return to banks on personal checking accounts was essentially unchanged or even lower (again depending upon bank

[1]These figures are a compilation of data taken from the Federal Deposit Insurance Corporation's Item Reference Lists, which, in turn, are taken from Call Reports each insured bank submits to the FDIC.

size) over the four year period covered by the study, despite the increases in service charges.[2]

Banks, like any other business, must make a profit in order to survive and prosper. In fact, federal law requires that federally insured banks be operated in a safe and sound manner. 12 U.S.C. § 1818. In order to do so in a newly competitive environment, many banks have chosen to impose fees upon formerly free or low cost services provided to their customers.[3] The decision of the California Supreme Court in this case seriously limits the ability of banks to establish service charges generally. While the case technically concerns only "overdraft" charges, there is no logical basis for distinguishing the case from any other fees which a bank might choose to charge for any of its services. If banks in California are no longer so freely able to charge the fees its customers are willing to pay, they must again look to the spread between interest earned and interest charged in order to make a profit. They must pay depositors less or charge borrowers more. And yet, as we pointed out above, that is no longer a practical choice for banks, because their customers may then choose to take their business elsewhere, even out of state, where banks with the unfettered ability to establish service charges have not been forced into such Draconian choices. That can only be harmful to the safety and soundness of banks in California. The state does not have the lawful capacity to inflict such harm upon federal instrumentalities,

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[2]*Bank Service Charges and Fees: Their Impact on Consumers.* A Study of the Board of Governors of the Federal Reserve System at the Request of the Consumer Advisory Council, at 4-5.

[3]*Id.* at 8-9.

such as the national bank appellant in this case or other national bank members of the American Bankers Association.

SUMMARY OF THE ARGUMENT

As a national bank, the appellant Crocker is a federal instrumentality, subject in its operations to the plenary jurisdiction of the Comptroller of the Currency. In this respect, it is entirely comparable to a California-based federal savings and loan association subject to the plenary jurisdiction of the Federal Home Loan Bank Board. This Court has previously held California state law inapplicable to federal savings and loan associations because that law was preempted by the Bank Board's regulations. Since the Comptroller of the Currency in this case has, lawfully, specifically authorized national banks to assess whatever service charges the banks' business judgment dictates, it is clear that this Court's precedents govern here and compel a different result from that reached by the California Supreme Court. Insofar as the court below applies its construction of state law to a national bank, it has decided an important question of federal law in a way in conflict with applicable decisions of this Court.

ARGUMENT

I. Background Of The Case

The named plaintiff in the case below, Paul Perdue, once wrote a check, drawn on his account at Crocker National Bank, for which sufficient funds were not on deposit. It was not an unusual occurrence, and it was dealt with in a not unusual manner. The bank assessed a six dollar charge against Mr. Perdue. From

this seemingly insignificant incident, which never should have occupied the time and attention of any court,[4] has grown a major lawsuit, soon to enter its tenth year (Appendix to Appellant's Jurisdictional Statement at 3a, n. 4 *Crocker National Bank v. Perdue*, No. 85-1035 (U.S. Dec. 16, 1985)). The plaintiff, claiming that it only costs a bank 30 cents to process a nonsufficient funds ("NSF") check, filed suit alleging that a six dollar charge was unconscionable (App. 10a). Suit was filed in March, 1977, twice amended, and refiled in July, 1978, as a purported class action, on behalf of the named plaintiff and either all other persons having checking accounts at the bank or all customers who have paid NSF charges to the bank. The Superior Court dismissed the complaint in February, 1979, for failure to state facts sufficient to constitute a cause of action (App. 38a). The Court of Appeal, First Appellate District, affirmed in March, 1983 (App. 40a). The California Supreme Court reversed in July, 1985. Among other things, the court held that a six dollar charge for processing NSF checks *might* be unconscionable, and that the plaintiff was entitled to a trial in order to attempt to prove that it was. As a matter of state law, that decision is unreviewable by this Court. However, the Court held that state law, as so construed, applied to a national bank, since, according to the Court, no federal law has preempted the state law simultaneously declared by the Court. The case was remanded to the

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[4] "De minimis non curat lex" is a principle of long standing. *See, e.g., Porter v. Rushing*, 65 F. Supp. 759 (W.D. Ark. 1946) (Office of Price Administration lawsuit to recover $9 in "overcharges" from a poor woman was dismissed under this principle.) The maxim is now apparently more honored in the breach.

superior court for further proceedings, and Crocker National Bank timely filed its Jurisdictional Statement in this Court.

II. State Law, As Construed By The California Supreme Court, Is Preempted By Lawful Regulations Of The Comptroller Of The Currency

National Banks, such as the Appellant Crocker National Bank, are federal instrumentalities. *American Bank & Trust Co. v. Dallas County*, 103 S. Ct. 3369, *reh. den.* 104 S. Ct. 39 (1983); *Iowa-Des Moines National Bank v. Bennett*, 284 U.S. 239 (1931); *Owensboro National Bank v. City of Owensboro*, 173 U.S. 664 (1899). This Court has been holding, at least since 1819, that it is unconstitutional for states "to retard, impede, burden, or in any manner control the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government." *McCullough v. Maryland*, 4 Wheat. (17 U.S.) 316, 436 (1819). That case, like this one, involved the efforts of a state to impede, burden and control a bank chartered by the federal government.

National banks have the statutory power to receive deposits pursuant to the National Bank Act. 12 U.S.C. § 24. Necessarily implied in this, and any other grant of power to the banks, is the power of national banks to charge fees for services rendered. The Comptroller of the Currency is specifically charged, by the National Bank Act, with the "execution of all laws passed by Congress relating to the issue and regulation of a national currency" (12 U.S.C. § 1), of which, of course, the National Bank Act is one.

While the California Supreme Court is clearly correct in stating that "[n]o provision of federal law

discusses bank charges for NSF checks, or, for that matter, bank charges for any services performed for depositors" (App. 2a), that hardly seems to matter much to the outcome of this case. The fact of the matter is that the Comptroller, having the clear authority to do so, has directed that "[a]ll charges to customers should be arrived at by each bank on a competitive basis" (12 C.F.R. § 7.8000 (1982); 36 Fed. Reg. 17,000, 17,018 (Aug. 26, 1971). This Court has held that "Federal regulations have no less preemptive effect than federal statutes. . . . A preemptive regulation's force does not depend upon express Congressional authorization to displace state law." *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141, 153-154 (1982).[5] This ruling of the Comptroller is the one that was in effect at the time this alleged cause of action arose.[6] Even the plaintiff in the case below concedes that the six dollar charge imposed by the bank was "similar" to the fee schedules available elsewhere in the market (Complaint, ¶ 25, App. 58a. *See also* Jurisdictional Statement at 5, n. 3). Either the bank has conformed to

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[5]In *Fidelity Federal*, too, there was no federal statute which specifically governed the issue at hand—in that case whether California law pertaining to "due on sale" clauses in mortgages could be applied to federal savings and loans. The Federal Home Loan Bank Board, having powers over savings and loans comparable to the Comptroller's powers over national banks, had concluded that the state law in that case was preempted as to federal savings and loans by force of the Bank Board's regulations.

[6]The Comptroller subsequently amended the regulation in order to make it perfectly clear that state laws which prohibit, restrict or limit the amount of service charges assessed by banks are preempted. 12 C.F.R. § 7.8000(c) (1985).

the explicit direction of the Comptroller or, if it has not, its charges are subject to review only by the Comptroller, whose regulation would be in issue, and only for failure to set the charges "on a competitive basis." If the California Supreme Court's decision in this case stands, then the bank will be required to establish its charges on some basis other than a competitive one and thus be in violation of the Comptroller's regulation.

Therefore, the state law at issue here is nullified because of an actual conflict with federal law. "Such a conflict arises when 'compliance with both federal and state regulations is a physical impossibility.' " *Fidelity Federal*, 458 U.S. at 153 (quoting *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-143 (1963)).

Federal law has been held to preempt state laws pertaining to the deposit-taking function of banks in a number of cases. In *Franklin National Bank v. New York*, 347 U.S. 373 (1954), a state law governing the advertising of savings accounts was held to be preempted by the National Bank Act, even though the National Bank Act said nothing about advertising. In *First National Bank v. California*, 262 U.S. 366 (1923), a state law governing the escheat of dormant deposit accounts in banks was held to be preempted by the National Bank Act even though the National Bank Act said nothing about the disposition of dormant accounts.[7] What the National Bank Act does

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[7]The law was amended in 1982. See 12 U.S.C. § 484(B). Congress may consent to the application of state laws to federal instrumentalities if it chooses to do so, but there has been no Congressional consent to the application of state laws pertaining to service charges to national banks.

say is that the Comptroller is responsible for the execution of that law.

> Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. . . . When the administrator promulgates regulations intended to preempt state law, the court's inquiry is similarly limited:
>
> > If [h]is choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned.

Fidelity Federal, 458 U.S. at 153, 154 (citations omitted, quoting from *United States v. Shimer*, 367 U.S. 374, 383 (1961)).

In this case, no serious argument could be advanced that the Comptroller of the Currency lacks authority to adopt rules and regulations governing any aspect of a national bank's deposit taking function. Nor can any serious argument be advanced that it is "arbitrary" for the Comptroller to authorize the charging of fees for services rendered by the banks which are set on a competitive basis. Nor is there anything in the language of the National Bank Act or its legislative history which indicates that Congress has ever felt otherwise. The Comptroller advanced logical and practical reasons for allowing the imposition of service charges (subject only to *his* review) at a level which would be not only compensatory and profitable to the

banks, but also which would serve as a deterrent to the misuse of banking services. 12 C.F.R. § 7.8000(b) (1985). It represents a reasonable accommodation of the Comptroller's mandate to assure the safety and soundness of banks subject to his jurisdiction and the interests of consumers. He has acted within his authority, and his rulings should be entitled to preemptive effect.

CONCLUSION

Because the California Supreme Court has denied preemptive effect to the Comptroller's regulations, and its decision cannot be reconciled with precedents established by this Court, particularly in *Fidelity Federal Savings & Loan v. de la Cuesta*, and because of the deleterious effect of this decision upon national banks in California, the American Bankers Association respectfully urges the Court to note probable jurisdiction in this case.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1985

CROCKER NATIONAL BANK,

Appellant,

v.

PAUL PERDUE,

Appellee.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF CALIFORNIA

BRIEF OF THE CALIFORNIA BANKERS CLEARING HOUSE ASSOCIATION, *AMICUS CURIAE*, IN SUPPORT OF THE JURISDICTIONAL STATEMENT

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TABLE OF CONTENTS

	PAGE
Interest of *Amicus Curiae*	1
Summary of Argument	2
ARGUMENT	3
I. The Power Claimed by California Is Regulatory.	4
II. California Has No Regulatory Authority Over National Banks.	5
Conclusion	13

TABLE OF AUTHORITIES

Cases

Conference of Federal Savings & Loan Associations v. *Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd summarily*, 445 U.S. 921 (1980)	10
D'Oench, Duhme & Co. v. *FDIC*, 315 U.S. 447 (1942)	6
Easton v. *Iowa*, 188 U.S. 220 (1903)	10
Farmers' & Mechanics' National Bank v. *Dearing*, 91 U.S. 29 (1875)	10
Fidelity Federal Savings & Loan Association v. *De la Cuesta*, 458 U.S. 141 (1982)	8
First Agricultural National Bank v. *State Tax Commission*, 392 U.S. 339 (1968)	5, 6, 9

PAGE

First National Bank v. *Missouri*, 263 U.S. 640 (1924) 9, 10
Franklin National Bank v. *New York*, 347 U.S. 373 (1954) 6, 7, 11, 12
Marquette National Bank v. *First of Omaha Service Corp.*, 439 U.S. 299 (1978) 10
McClellan v. *Chipman*, 164 U.S. 347 (1896) 4, 9, 10, 11
M'Culloch v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819) 6
National Bank v. *Commonwealth*, 76 U.S. (9 Wall.) 353 (1869) 4, 5
National State Bank v. *Long*, 630 F.2d 981 (3d Cir. 1980) 10
Society for Savings v. *Bowers*, 349 U.S. 143 (1955) 5
United States v. *L. Cohen Grocery Co.*, 255 U.S. 81 (1921) 12
Wallis v. *Pan American Petroleum Corp.*, 384 U.S. 63 (1966) 6

Statutes

Bank Holding Company Act of 1956:
12 U.S.C. § 1842(d) (1982) 7
Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 11
Section 501(a) 12
Section 501(b)(4) 12
Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028 10
McFadden Act:
12 U.S.C. § 36(c) (1982) 7, 10

PAGE

National Bank Act of 1864 (as amended):

12 U.S.C. § 24 (Seventh) (Supp. II 1984) .. 3
12 U.S.C. § 85 (1982) 7, 12
12 U.S.C. § 484 (1982) 3

R.S. § 5197 7

Legislative Materials

67 Cong. Rec. 2841-42 (1926) 10
67 Cong. Rec. 2859-60 (1926) 10
67 Cong. Rec. 3240 (1926) 10
67 Cong. Rec. 9291 (1926) 10

102 Cong. Rec. 6861 (1956) 8

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BRIEF OF THE CALIFORNIA BANKERS CLEARING HOUSE ASSOCIATION, *AMICUS CURIAE*, IN SUPPORT OF THE JURISDICTIONAL STATEMENT

This brief is filed under Rule 36.1 of the Rules of this Court with the consent of all the parties.

Interest of *Amicus Curiae*

The California Bankers Clearing House Association is an association of eight major commercial banks in the State of California which clears checks and other commercial items in the State.[1] Through its counsel, the Association

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[1] The members of the Association are Bank of America National Trust and Savings Association, The Bank of California, N.A., Crocker National Bank, First Interstate Bank of California, Lloyds Bank California, Security Pacific National Bank, Union Bank, and Wells Fargo Bank, N.A.

regularly appears as *amicus curiae* before this Court and other appellate courts in cases raising significant legal questions relating to banking. The Association has a strong interest in the Court's exercising plenary jurisdiction over this appeal and preventing the State of California from engaging in rate regulation of national banks without warrant under any act of Congress.

Summary of Argument

The decision below rests on the proposition that the States possess rate regulatory authority over national banks, entities organized and existing solely by reason of federal authority and empowered by Congress to conduct the business of commercial banking. The pretense that California proposes to do no more here than apply "the common law governing all commercial transactions" (JS 36a) is spurious.[2]

The States, including California, possess no independent regulatory authority over the rates charged by national banks for banking services. Only to the extent Congress has chosen expressly to incorporate state law into federal law can the States control the banking operations of national banks. Any other application of state regulatory law is inconsistent with federal supremacy. Since Congress has not adopted state law with respect to regulation of deposit account charges, California law does not govern such charges.

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[2] The jurisdictional statement and its appendix are cited as "JS" with a page number; "JS —a" citations are to the appendix.

ARGUMENT

The jurisdictional statement shows that the provisions of state statutory law applied to national banks by the decision below conflict with the power of national banks to receive deposits pursuant to 12 U.S.C. § 24 (Seventh) (JS 8-13), with the Comptroller's exclusive regulatory power over national banks under 12 U.S.C. § 484 (JS 14-17) and with national policy regarding the pricing of banking services (JS 17-22). Each of these propositions is fully explicated in the jurisdictional statement, is clearly correct, and requires no restatement here; each is as well an adequate warrant for the exercise of the Court's jurisdiction and reversal of the decision below. We suggest here an additional and fundamental ground that calls for the Court to act to sustain federal authority against the claim of power made by California: California lacks regulatory power over the banking business of national banks *ab initio*, whether or not Congress has affirmatively acted so as to occupy the field within which a particular form of regulation falls or has provided a federal directive in conflict with state law. This conclusion follows from the status of national banks as creatures of federal authority established to conduct the business of commercial banking.

I.

The Power Claimed by California Is Regulatory.

The California Supreme Court has directed that a state trial court determine whether certain deposit account charges of a national bank are "unreasonable." As a part of that "adjudication," the trial court apparently is to consider whether a national bank demand deposit account agreement is a "contract of adhesion" (JS 8a), the national

bank's "basis and justification" for the charges challenged (JS 11a), whether retail banking in California is a "freely competitive market" or an "oligopoly" (*id.*), the national bank's "cost" of providing the services (*id.*), and the "true value" of the national bank's services (*id.*). Such an inquiry is said to be called for by provisions of California statutory law which in turn are said to be "part of the common law governing all commercial transactions" and which "*regulate* not only [the] sale of bank services but the sale of groceries, automobiles, furniture or medical services" (JS 36a) (emphasis added).

Thus, the California court concluded that this case involved nothing more than the application of ordinary principles of contract law to the contracts of national banks and was controlled by such decisions of this Court as *National Bank* v. *Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869), and *McClellan* v. *Chipman*, 164 U.S. 347, 357 (1896) (see JS 27a). Whatever the current law of California may be (see JS 10a-11a), however, it has not generally been thought in this country that judicial review and revision of prices to insure their "reasonableness" is part of the law of contracts. Rather, when the law—state or federal—has sought to displace the market in the determination of prices it has done so by the statutory establishment of particular standards to be administered by agencies created for that purpose, and such action has normally been limited to industries classed as public utlities and granted some form of monopoly.[3] The law of contracts has never been thought to service this function—its purpose is instead to

[3] Applications of price regulation beyond the public utility field have occurred in times of war or other emergency, and in recent years with respect to energy prices and, in a few localities, residential rents. In each instance, specific legislation has been enacted for a particular reason and with carefully articulated standards.

provide neutral rules producing certainty and protecting expectations in the conduct of commerce.

As we show below, California could not by a specific statutory scheme regulate national bank deposit account charges, and it cannot achieve the same end by calling such regulation "contract law." This Court is not bound by a state court's characterization of state law when determining whether a State has intruded on federal prerogatives, *see First Agricultural National Bank* v. *State Tax Commission*, 392 U.S. 339, 347 (1968); *Society for Savings* v. *Bowers*, 349 U.S. 143, 151 (1955), and, like a rose, regulation by any other name is regulation.

II.

California Has No Regulatory Authority Over National Banks.

We do not dispute the settled proposition that national banks are "governed in their daily course of business far more by the laws of the State than of the nation." *National Bank* v. *Commonwealth, supra*, 76 U.S. (9 Wall.) at 362 (see JS 27a). State health and safety laws (such as building and fire codes, elevator inspection requirements, health codes for employee cafeterias, etc.), so long as uniform in their application, apply to national banks as to other commercial enterprises because they do not affect the functioning of national banks as banks and because Congress has not chosen to supply a body of federal law to give effect to these necessary exercises of police power. The same is true with respect to construction and enforcement of the contracts made by national banks. *Id.*[4]

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[4] Consequently, as the California Court noted (JS 28a-29a), article 4 of the Uniform Commercial Code, governing the contract

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In contrast, state authority to regulate the banking business of national banks as such is wholly inconsistent with the fact that national banks are creatures of federal power —a power unquestioned since *M'Culloch* v. *Maryland,* 17 U.S. (4 Wheat.) 316 (1819), *see Franklin National Bank* v. *New York,* 347 U.S. 373, 375 (1954). This is so whether or not national banks as they exist today are federal "instrumentalities" in the same sense as was the Second Bank of the United States. *See First Agricultural National Bank* v. *State Tax Commission, supra,* 392 U.S. at 340-41; *id.* at 354-58 (Marshall, J., dissenting).

Congress has for over a century legislated with respect to national banks on the premise that these creatures of its power are governed in the fundamentals of their banking operations exclusively by its own acts. Congress has clearly presumed that state law regulating the provision of banking services, the price of those services, the location of banking offices and the interstate expansion of banking operations is to be applied to national banks only if incorporated into federal law by Congress itself.

The Court recognized Congress's established practice of applying state law to the operations of national banks, when it chooses to do so, by means of express adoption when the Court struck down a state restriction on advertising as applied to national banks in *Franklin National Bank* v. *New York, supra.* The Court held, "We find no indication that

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rights and liabilities of parties to the bank deposit and collection process, applies to the contracts of national banks, as does article 3 of the Code, which governs negotiable instruments. These provisions are paradigms of neutral rules that facilitate commerce by providing certainty and protecting expectations. Even such provisions cannot be applied, however, to frustrate federal policy. *D'Oench, Duhme & Co.* v. *FDIC,* 315 U.S. 477, 455-59 (1942); *see also Wallis* v. *Pan American Petroleum Corp.,* 384 U.S. 63, 68 (1966).

Congress intended to make this phase of national banking subject to local restrictions, as it has done by express language in several other instances." 347 U.S. at 378; *see id.* n.7.

Thus, Congress has made state usury laws, with specified exceptions, applicable to the interest charges of national banks by what is now 12 U.S.C. § 85 and its predecessor, R.S. § 5197. Congress has subjected national banks to state branching laws by the McFadden Act, 12 U.S.C. § 36(c) (1982). Congress has by the Douglas Amendment, 12 U.S.C. § 1842(d) (1982), subjected the acquisition of national banks by out-of-state bank holding companies to the laws of each State governing such acquisition of state banks.

The wording of Section 85 of the National Bank Act and of both the McFadden Act and the Douglas Amendment is quite instructive as to Congress's understanding of the limits of state authority: Section 85 provides that national banks may charge interest "at the rate allowed" by state law "and no more, except that where by the laws of any State a different rate is limited for *banks organized under State laws,* the rate so limited shall be allowed" for national banks (emphasis added). Similarly, the McFadden Act provides that a national bank may establish and operate new branches "if such establishment and operation are at the time authorized to *State banks* by the statute law of the State in question . . . subject to the restrictions as to location imposed by the law of the State on *State banks*" (emphasis added). The Douglas Amendment provides that an out-of-state bank holding company may not acquire a bank, national or state, in a State "unless the acquisition of . . . *a State bank* by an out-of-State bank holding company is specifically authorized by the statute laws of the State in which such bank is located . . ." (emphasis added).

It is clear from the reference in each statute to state law as governing *state* banks that Congress presupposed that the States have regulatory authority only over state banks and that only Congress itself could place national banks under similar strictures.[5] Indeed, if the States had general regulatory jurisdiction over national banks, each of the congressional actions described above would have been superfluous and Congress could have achieved its purposes by a single, simple provision preventing state discrimination against national banks.

In a similar context, that of federal savings and loan associations, the Court recently observed that if those federally created entities "were expected to conform to state law except where explicitly pre-empted in the Act itself, the provisions incorporating specific aspects of state law were needlessly repetitive." The Court continued, "we decline to construe the Act so as to render these provisions nugatory, 'thereby offending the well-settled rule that all parts of a statute, if possible, are to be given effect.'" *Fidelity Federal Savings & Loan Association* v. *De la Cuesta,* 458 U.S. 141, 163 (1982).[6]

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[5] The legislative histories of these statutes evidence this assumption. For example, Senator Bricker during debate on the Douglas Amendment said:

> "The National Bank Act recognizes the exclusive jurisdiction of the Federal Government over national banks just as the States have exclusive jurisdiction over State banks. The branch banking law is cited as a precedent for *giving* powers to States over national banks. The branch-banking law is the only major exception to the general rule that the Federal Government has exclusive jurisdiction over national banks."

102 Cong. Rec. 6861 (1956) (emphasis added).

[6] While the question posed in *Fidelity* arose from a conflict between a federal administrative regulation and a general rule of state

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This Court's consistent decisions to the effect that "the States are without power, unless authorized by Congress, to tax federally created, or, as they are presently called, national, banks," *see First Agricultural National Bank* v. *State Tax Commission, supra,* 392 U.S. at 340, are squarely on point. Indeed, state power to impose uniform, nondiscrimatory sales and use taxes on national banks is considerably less of an intrusion on the performance of banking functions than is California's claim of power to regulate rates—even if California purports to extend similar rate regulation to every aspect of its economy.

The only decision of this Court even arguably suggesting broad state regulatory jurisdiction over national banks is *First National Bank* v. *Missouri,* 263 U.S. 640 (1924). There the Court held, with three Justices dissenting, *id.* at 662-68, that Missouri could enforce against a national bank in its own courts its own statutory prohibition against the establishment of branches, *id.* at 659-60. The Court first determined, however, that federal law itself did not allow national banks to establish branches, *id.* at 656-59, so the actual question of state authority was indeed a peculiar and limited one—*i.e.,* whether a State could enforce a prohibition of its own that was not merely consistent with, but in fact duplicative of, federal law.

Moreover, the majority opinion in the *Missouri* case, while relying on broad language from the 1896 decision in *McClellan* v. *Chipman, supra, see* 263 U.S. at 656, did not distinguish, overrule or even take note of the line of deci-

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property and contract law, not from a claim of state regulatory power over federal entities (and thus the issue was one of preemption, not lack of state power *ab initio*), the Court followed the observation quoted above with a reference to the holding of *Franklin National.*

sions relied upon by the dissent, *see id.* at 663-65, which both antedated and followed *McClellan*: *e.g., Farmers' & Mchanics' National Bank* v. *Dearing,* 91 U.S. 29, 31-34 (1875); *Easton* v. *Iowa,* 188 U.S. 220, 229-30, 237-39 (1903). This omission vitiates the authority of the *Missouri* majority opinion, for the continuing validity of *Dearing* was reaffirmed only eight years ago by a unanimous Court. In *Marquette National Bank* v. *First of Omaha Service Corp.,* 439 U.S. 299, 308 (1978), the Court said:

> "Omaha Bank is a national bank; it is an 'instrumentalit[y] of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.' *Davis* v. *Elmira Savings Bank,* 161 U.S. 275, 283 (1896). The interest rate that Omaha Bank may charge in its BankAmericard program is thus governed by federal law. See *Farmers' & Mechanics' Nat. Bank* v. *Dearing,* 91 U.S. 29, 34 (1875)."

First National Bank v. *Missouri* simply cannot be viewed as correct in light of this Court's other decisions and of consistent congressional understanding to the contrary.[7]

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[7] The legislative history of the McFadden Act expressly shows that Congress was well aware of the *Missouri* decision, *see, e.g.,* 67 Cong. Rec. 2841-42, 2859-60 (1926) (remarks of Reps. Nelson and Celler), yet still considered it to be solely within the power of the federal government to regulate the branching of national banks, *see, e.g.,* 67 Cong. Rec. 3240, 9291 (1926) (remarks of Rep. McFadden and Sen. Shipstead).

The holding of *First National Bank* v. *Missouri* is also no longer valid on its facts for the additional reason that the Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, 80 Stat. 1028, delegated exclusive enforcement authority over national banks to the Comptroller of the Currency. *See National State Bank* v. *Long,* 630 F.2d 981, 988 (3d Cir. 1980); *see also Conference of Federal Savings & Loan Associations* v. *Stein,* 604 F.2d 1256 (9th Cir. 1979), *aff'd summarily,* 445 U.S. 921 (1980).

In sustaining the power of the State to regulate national bank deposit account charges, the California court did not address the foregoing analysis. Instead, it advanced a broad reading of the holding in *McClellan* v. *Chipman, supra* (JS 27a), a restriction of *Franklin National* to regulations that might deter consumers from making deposits (JS 29a-31a), and a reference to the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 ("DIA of 1980"), and its legislative history as showing that Congress had not "intended by silence to preempt all state laws regulating charges in contracts between banks and depositors" (JS 32a and n.37).

McClellan v. *Chipman,* like any other decision, cannot be abstracted from its facts and made to do duty as a sweeping acknowledgement of state regulatory authority over national banks. The statute there in question was a typical act nullifying fraudulent conveyances; it did not become a regulation of banking when applied to banks, and it did not affect the essentials of the banking business—banking offices, banking services and banking charges. While the California court would have it that the state law here in question is of the same character as that in *McClellan,* the undeniable fact is that if that law is applied to charges in respect of a bank's deposit accounts, that law is being applied as a regulation of banking itself.

Likewise, *Franklin National* can hardly be limited to regulations that a state court views as deterring deposits. Indeed, a paraphrase of words from the holding of *Franklin National* shows its direct application here: it is impossible to believe that Congress authorized national banks to engage in the business of accepting demand deposits (one of the basic functions of a national bank) but, without any "affirmative indication," caused that authority to be subject to state control of the economic terms on which those de-

posits are accepted, whether those terms are service charges, minimum balance requirements, or interest payments on average balances. *See* 347 U.S. at 377-78.

Finally, the California court's reliance on a non-preemption provision in the DIA of 1980 proceeds from a false premise. That provision, § 501(b)(4), 94 Stat. 162, is a carve-out from a broad preemption of mortgage rates charged by *all* depository institutions, § 501(a), 94 Stat. 161-62, not just national banks. As noted above, national banks are not subject to state interest-rate regulation in the first place; rather 12 U.S.C. § 85 adopts state interest rate limitations, with certain exceptions, as *federal law* governing national banks. Thus, the limitation on preemption in Section 501(b)(4) says nothing about state regulatory authority over the charges of national banks in the absence of express congressional adoption or delegation.

Congress has not made state law regulating bank deposit account charges applicable to national banks, and, therefore, state law does not so apply. Were Congress ever to consider adopting state law as governing the operations of national banks in this respect, it is inconceivable that it would as well permit the regulatory mechanism California has chosen—after-the-fact class action litigation seeking hundreds of millions of dollars of damages on the theory that charges imposed for years in accordance with a bank's standard contracts and practices are "unreasonable" or "unconscionable" in amount. Indeed, this Court has held that, at least in the penal context, federal legislation prohibiting the making of "any unjust or unreasonable rate or charge" is unconstitutionally vague and the equivalent of a statute precluding "all acts detrimental to the public interest when unjust and unreasonable in the estimation of the court and jury." *United States* v. *L. Cohen Grocery Co.*, 255 U.S. 81, 89 (1921).

CONCLUSION

For the reasons stated, this Court should exercise its plenary jurisdiction to review and reverse the judgment of the Supreme Court of the State of California.

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IN THE
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OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

Brief of Amicus Curiae City National Bank In Support of Appellant Crocker National Bank

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE CITY NATIONAL BANK	1
SUMMARY OF ARGUMENT	2
ARGUMENT	3
CONCLUSION	12

TABLE OF AUTHORITIES

Cases Page

Perdue v. Crocker National Bank, 38 Cal.3d 913 (1985) 11, 12

Federal Statutes and Regulations

12 U.S.C.
24(7) 5
484 5
12 C.F.R.
7.8000 2,6,9,11

Public Laws

Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 4
The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub.L.No. 96-221, 94 Stat. 132 4

Congressional Materials

Competition & Conditions in the Financial System, Part I: Hearings Before the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs 97th Cong., 1st Sess. (1981) . . . 4
S. Rep. No. 363, 96th Cong., 23d Sess. (1979) 5

State Statutes

Uniform Commercial Code 4-104 . . . 8
California Civil Code §1719 9
California Penal Code §476a 9

INTEREST OF THE AMICUS CURIAE CITY NATIONAL BANK

Amicus curiae, City National Bank ("CNB") is a national bank. It presently offers deposit accounts to the general public at rates published and made known through its Schedule of Rates and Charges, set in accord with the Regulations of the Comptroller of the Currency. (As a national bank, CNB is subject to the authority and regulations of the Comptroller of the Currency.) CNB is directly affected by the decision below as it faces conflicting instructions from the California Courts and the Comptroller with respect to pricing of services. The California Supreme Court, by its decision, requires review and modification, in state court proceedings, of the price terms on which CNB may offer deposit accounts to its customers. These price terms may be contrary to those set by the Comptroller (and in fact must be different given the conditions trial courts are directed to consider).

CNB is concerned with the conflict between its obligations under the Comptroller's regulations and examination procedures, especially 12 C.F.R. 7.8000 (1985), and state court-ordered repricing of banks's services. Review is essential to establish the fact of federal preemption ignored by the California Supreme Court.[1]

SUMMARY OF ARGUMENT

The California Supreme Court, by its ruling, would make trial courts, rather than the marketplace, final arbiters of pricing in "oligopolistic" industries, including the banking industry. The Court's ruling is particularly inappropriate in the case of national banks which have been engaged in fierce competition since deregulation, and yet have also remained strictly governed by the rulings of the Comptroller of the Currency.

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[1] Pursuant to Supreme Court Rule 36.2, amicus curiae CNB has obtained the written consent of counsel of record for all parties hereto to the filing of this brief.

There has been federal preemption of the regulation of national banks by Congress. The duties of regulating the industry have been passed to the Comptroller of the Currency. Especially in light of the Comptroller's specific ruling with respect to charges assessed in the case of checks drawn against insufficient funds, the California Supreme Court overstepped its jurisdiction. The California Supreme Court should have acknowledged federal preemption and deferred ruling. To enable national banks to follow the mandates of deregulation set by Congress and the specific directives of the Comptroller, the Supreme Court should grant review.

ARGUMENT

This case comes before the United States Supreme Court at a time when banks and the banking industry are working to meet society's needs as determined by the marketplace. After decades of complacency, consumers, banks, and finally

Congress grew dissatisfied with the limits of regulation. The Depository Institutions and Monetary Control Act of 1980, Pub. L.No. 96-221, 94 Stat. 132 and the Garn-St. Germain Act of 1982 (the "Acts") were the result of renewed interest in applying market economics to banking.

A purpose of the Acts was to remove regulations enacted in the mistaken belief that they would protect the public. Congress concluded, after review, that the very statutes and regulations enacted to protect the public injured many as few earned competitive rates of interest. Competition and Conditions in the Financial System, Part I: Hearings Before the Senate Committee on Banking, Housing and Urban Affairs, 97th Congress, 1st Sess. 51, 55 (1981). Banks also suffered as depositors withdrew their savings and placed them in unregulated, uninsured accounts at higher rates of interest.

Tied to an expectation of higher interest rates on deposits was the realization that services would

bear their fair proportional costs. ("It seems clear that if institutions are going to pay higher interest rates . . . that institutions are going to have to charge more for the services they offer. . . ." S. Rep. No. 363, 96th Cong., 23d Sess. (1979).) Low interest rates would no longer be available to subsidize services.

This new era of "deregulation" did not mean "no regulation." The Comptroller of the Currency was and is charged with regulating and monitoring national banks. (12 U.S.C. §24(7) and 12 U.S.C. §484.) Banks and banking remain the subject of strict scrutiny in a pervasive sphere of federal regulation.

Into this purview would step an interloper, an outsider, the California Supreme Court. The Supreme Court of California would impose a trial court's determination of "fair and reasonable" charges in place of fees set by the marketplace, Congress and the Comptroller of the Currency.

Under Perdue, banks would be subject to litigating each pricing factor at the whim of any consumer who might, without data or documentation, allege the charge "unreasonable."

The Comptroller of the Currency is charged with regulating and monitoring the conduct and practices of national banks. In accord with its duties, the Comptroller promulgated 12 C.F.R. 7.8000. That section outlines the criteria to be used by national banks when setting various service charges, and particularly those assessed against writers of NSF checks.

One criterion is cost. Checks are usually processed electronically with a minimum of human contact. NSF checks processed at City National Bank require extensive, expensive additional handling. Normally a check, after having been micro-encoded with the amount, is posted by computer to the customer's account. A check will post only when there are sufficient funds to pay the item. After the com-

puter unsuccessfully tries to post an NSF item to the customer's account, the check is posted instead to a reject report.

Reject reports are prepared for each branch and sent, with the NSF items, by internal mail to the respective branch. At the branch, an officer reviews the rejected items report and each posted item to determine whether the check should be paid or returned unpaid. In evaluating a rejected item, the officer reviews the customer's past account history and number of past rejected items. The officer may attempt to call the customer to request a deposit to cover the check.

All NSF checks to be paid are batched together at the branch. The separate NSF batch is then returned to the computer center and encoded with a special transaction code to force the item to post NSF.

All checks to be returned NSF are so stamped, separated according to the payee's bank and bundled. Tape totals are run of each bundle. Bundles and tapes are then returned to the computer center. At the computer center, checks received from all branches are combined by payee's bank, added again, balanced and taken to the clearing house to be traded that evening during bank settlement.

Time is of the essence during these transactions as a bank is deemed to have finally paid an item if it is not returned by midnight of the next banking day. (Uniform Commercial Code §4-104.) As is evident from the outline above, the time required to and attendant costs of processing a check drawn against insufficient funds are substantial. High fees are cost-justified.

A customer unwilling to pay the high cost of presenting NSF checks simply need not write checks against insufficient funds. In the alternative, a customer may obtain overdraft protection in the

form of a loan which automatically funds upon presentment of checks drawn against insufficient funds. (Normal loan-qualifying requirements apply.) The writing of NSF checks is not required and is in fact discouraged. NSF check fees need not be incurred.

NSF checks serve no legal purpose. In California, it is a crime punishable by imprisonment to knowingly with fraudulent intent write a check against insufficient funds (Cal. Penal Code §476a). Futhermore, issuing an NSF check subjects the maker to mandatory punitive damages if payment is not made after written demand. (Cal. Civ. Code §1719.) It is not unreasonable to charge a customer with knowledge and proper management of his financial affairs and to expect the individual to act responsibily.

Responsible management of one's financial affairs was of particular concern to the Comptroller of the Currency. Under 12 C.F.R. 7.8000, banks

are instructed to go beyond mere cost plus profit pricing, particularly in the case of NSF check writing. Banks are also to price services to deter misuse by their customers. With respect to writing checks against insufficient funds, the regulation provides:

> "Certain deposit account services provided by banks, such as the honoring of checks drawn against non-sufficient funds, have the potential for misuse. It has been the Office position that service charges should discourage customers from frequently writing checks in amounts greater than their account balances."

Thus, national banks are faced with a clear directive from their regulating agency to fix charges at a rate which will deter customers from writing NSF checks.

City National Bank has complied with the Comptroller's directives. However, in Perdue, the California Supreme Court directs its trial courts to "consider not only the market price, but also the cost of the goods or services to the seller [citations], the inconvenience imposed on the seller [citations], and the true value of the produce or service [citations]" when setting reasonable prices for NSF fees and other bank services. (Perdue v. Crocker National Bank 38 Cal.3d 913, 927 (1985).)

The California Supreme Court ignores the fact that the market takes into consideration the very elements the trial court is to evaluate. It also appears unconcerned with the effect on banks such interference would have: on the mere allegation of a cost disproportionate to charges, a bank would be subjected to lengthy, costly litigation. Into normal business management is added a large unknown: the opinion of a trial court.

There is the further problem of an actual conflict between the Comptroller's directive of 12 C.F.R. 7.8000 and the California Supreme Court's ruling. Under the Comptroller's ruling, national banks are directed to assess fees in excess of market rates where necessary to discourage misuse of services, including NSF check writing. Under Perdue, national banks may be required to charge below-market rates to satisfy a trial court's sense of "fair dealing." National banks are faced with an impossible situation.

CONCLUSION

The conflicts inherent in the Comptroller's ruling and the California Supreme Court's decision mandate review. Without review, national banks are faced with deciding whether to follow the directives of their regulating agency or of the highest court in the state in which they do business. This decision directly affects CNB and all national banks doing business in California. For this

reason, amicus City National Bank respectfully urges this Court to address the merits of this appeal.

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In the Supreme Court of the United States

OCTOBER TERM, 1985

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Appellant,

v.

PAUL PERDUE,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

BRIEF OF UNITED STATES NATIONAL BANK OF OREGON AS AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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TABLE OF CONTENTS

Page

Interest of Amicus Curiae 1

Statement of the Case 2

Summary of Argument 3

Argument 3

Conclusion 7

TABLE OF CASES AND AUTHORITIES

CASES

Page

Anderson National Bank v. Luckett, 321 U.S. 233 (1943) 6, 7

Best v. United States National Bank, CA A32299 (Or. App., argued September 20, 1985) 2

Easton v. Iowa, 188 U.S. 220 (1902) 5

Fidelity Federal S. & L. Assn. v. de la Cuesta, 458 U.S. 141 (1982) 4

First Nat. Bank v. California, 262 U.S. 366 (1922) 6, 7

Franklin Nat. Bank v. New York, 347 U.S. 373 (1954) 5

McClellan v. Chipman, 164 U.S. 347 (1896) 5

McCulloch v. Maryland, 17 U.S. (4 Wheat.) 315 (1819) 6

Perdue v. Crocker Nat. Bank, 38 Cal. 3d. 913, 216 Cal. Rptr. 345 (1985) 4

OTHER AUTHORITIES

Page

Depository Institutions Deregulation and Monetary Control Act, Pub. L. No. 96-221, 94 Stat. 132 (1980) 1

Garn-St. Germain Depository Institutions Act Pub. L. No. 97-320, 96 Stat. 1469 (1982) 1

National Bank Act (12 U.S.C. § 1 et seq) 1, 4

12 C.F.R. § 7.8000 4

INTEREST OF AMICUS CURIAE

Pursuant to Supreme Court Rule 36.1, United States National Bank of Oregon, a national banking association ("USNB"), submits this brief as amicus curiae in support of appellant's jurisdictional statement. Written consent of the parties accompanies this brief.

USNB is a national banking association. As such it is governed by the National Bank Act (12 U.S.C. § 1 et seq). Thus USNB, like all national banks, has been affected by the federal policy of bank deregulation effected inter alia by the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469, and by regulations of the Comptroller of the Currency.

Deregulation has heightened greatly the competition in the market area of USNB for demand deposit accounts. Credit unions, savings and loan associations, and brokerage firms now offer such accounts and related services. Like other banks, USNB is sensitive to market conditions. Service charges and fees for USNB functions, including the receipt and operation of demand deposit accounts, are fixed in a competitive environment. The ability of USNB to attract and retain customers is dependent in large measure upon its depositors' receiving maximum benefits at a minimum overall cost.

Processing of nonsufficient fund ("NSF") items is a significant task involving several discrete operations. It is a sizable undertaking: In calendar 1984, USNB processed 593,192 NSF items. For the first 11 months of 1985 (the latest period for which data are available), 539,243 NSF items were processed.

Like appellant, USNB is involved in litigation contesting fees assessed customers who overdraw deposits. In *Best* v. *United States National Bank*, CA A32299 (Or. App., argued September 20, 1985), plaintiffs alleged that USNB's NSF charge was "unconscionable." The trial court granted USNB's motion for summary judgment. Plaintiffs appealed, and the case is pending before the Oregon Court of Appeals. USNB has argued to the Oregon appellate court that federal banking law precludes the state from placing conditions upon a national bank's deposit-related charges and that the supremacy clause thus requires an affirmance of the trial court's ruling.

STATEMENT OF THE CASE

Appellee (the "customer") challenged the fee charged by appellant (the "bank") to customers who write checks on nonsufficient funds. The trial court dismissed the customer's complaint for failure to state a claim. The Court of Appeal for the First Appellate District of California affirmed.

The California Supreme Court reversed. The court held that in signing the required signature card the

customer entered into an enforceable agreement with the bank which entitled the bank to charge a fee for NSF checks. The court further held, however, that the customer's allegation that the bank charged an "unreasonable" or "unconscionable" fee for NSF checks stated a claim on which relief could be granted under California law. The court then addressed and rejected the bank's argument that federal law preempts any such attempt by a state to regulate service fees charged by national banks on deposit accounts.

SUMMARY OF ARGUMENT

The customer has asserted the authority of a California state court to determine whether charges a national bank makes for deposit-related services are reasonable (under tests of the state's own devising). This assertion is incompatible with the powers bestowed upon national banks by the United States Congress and therefore unconstitutional under the supremacy clause of the United States Constitution.

Furthermore, the nationwide importance of this case calls for review and rectification at this time of the state court decision.

ARGUMENT

The California Supreme Court has ruled that federal banking law does not preempt a state's authority to regulate the terms and conditions of a national bank's agreement with its depositors. The California court is mistaken.

As the California court recognizes, section 24 of the National Bank Act authorizes banks to accept deposits. *Perdue* v. *Crocker Nat. Bank*, 38 Cal. 3d. 913, 216 Cal. Rptr. 345, 363 (1985). As the California court all but concedes, section 24 "authorize[s] banks to charge for deposit-related services as an incidental power necessary to carry on the business of receiving deposits * * *." 216 Cal. Rptr. at 363.[1] Particularly since the advent of deregulation, federal policy has allowed — indeed, encouraged — banks to base deposit account service charges on market conditions.[2] There can be little question, therefore, but that federal law precludes state control of a bank's NSF fees. *See Fidelity Federal S. & L. Assn.* v. *de la Cuesta*, 458 U.S. 141 (1982) (state regulation of due-on-sale clause preempted where federal law permitted, but did not require, federal savings and loans to include due-on-sale clause in their contracts).

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[1] The court's language is that this section "may" authorize banks to set fees for deposit-related services.

[2] The Comptroller has explained "[a]ll charges to customers should be arrived at by each bank on a competitive basis" and that "[i]n establishing deposit account service charges, the bank may consider, but is not limited to considering:

"(1) Costs incurred by the bank, plus a profit margin, in providing the service;

"(2) The deterrence of misuse by customers of banking services;

"(3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy;

"(4) Maintenance of the safety and soundness of the institution." 12 C.F.R. § 7.8000.

This Court consistently has interpreted broadly the powers attendant to a national bank's congressionally provided authority to receive deposits. Thus, for instance, *Franklin Nat. Bank* v. *New York*, 347 U.S. 373, 376 (1954), holds that "[t]he National Bank Act authorizes national banks to receive deposits without qualification or limitation," and therefore a state may not prohibit a bank's advertising of its authorized business. The Court underscored this ruling by emphasizing that state law would be preempted even were it to be shown that the state's citizens were in fact misled by the advertising in question. See also *Easton* v. *Iowa*, 188 U.S. 220 (1902) (a state cannot prohibit an insolvent national bank from receiving deposits).

Nor are the cases relied upon by the California court to the contrary. For example, in *McClellan* v. *Chipman*, 164 U.S. 347 (1896), which upheld the application to a national bank of a state law prohibiting certain transfers of property by insolvents, the Court declared "absolutely void" state laws which "expressly conflict with the laws of the United States or frustrate the purpose for which the national banks were created, or impair their efficiency to discharge the duties imposed upon them by the laws of the United States." 164 U.S. at 357. In the instant case, California's assertion of a right to regulate deposit-related charges conflicts with the congressional determination that banks have authority to set charges for deposit-related services and impedes the federal policy of deregulation. As this Court has long recog-

nized, the power to regulate is the power to frustrate. *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 315 (1819).

In both *Anderson National Bank* v. *Luckett*, 321 U.S. 233 (1943), and *First Nat. Bank* v. *California*, 262 U.S. 366 (1922), the Court addressed the constitutionality of state laws providing for the escheat to the state of deposit accounts in national banks. *Anderson* upheld state law, whereas the earlier *First Nat. Bank* refused to do so. A distinguishing basis of these decisions, as *Anderson* observed, is the principle that state laws may not affect the contractual relationship of a depositor and a national bank. In *Anderson*, state law allowed escheat "only on proof of abandonment in fact" of the account. 321 U.S. at 252. Because, as the Court explained, "appropriation by the state of property in fact abandoned * * * is * * * as old as the common law itself," escheat worked no alteration of the deposit contract. 321 U.S. at 251. In *First Nat. Bank*, by contrast, a state attempted to enforce a forfeiture of deposit accounts for "mere dormancy." 321 U.S. at 251. This, the Court held, was "incompatible with the purpose to establish a system of governmental agencies specifically empowered and expected freely to accept deposits from customers irrespective of domicil *with the commonly consequent duties and liabilities.*" 262 U.S. at 369 (emphasis added).

The distinguishing principle of *Anderson* and *First Nat. Bank* should be applied to prohibit California from imposing its law upon the terms of the depositor-

bank relationship. As the *First Nat. Bank* Court emphasized in concluding its opinion:

> "This court has often pointed out the necessity for protecting Federal agencies against interference by state legislation. The approved principle of obsta principiis should be adhered to." 262 U.S. at 370.

Finally, the issue posed by this appeal is of nationwide importance. The California decision if left to stand may subject national banks to the patchwork process of state-by-state re-regulation. Amicus, therefore, urges plenary review.

CONCLUSION

The California Supreme Court has wrongly decided an issue of federal constitutional law in a case of sweeping importance to the national banking industry. This Court should note probable jurisdiction and allow briefing and argument.

Respectfully Submitted,

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On Appeal from the Supreme Court of the State of California

BRIEF OF THE CALIFORNIA BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF APPEAL

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TABLE OF CONTENTS

	Page
Table of Authorities	ii
Interest of The *Amicus Curiae*	1
Summary of The Argument	2
Argument	3
1. The decision below will result in multitudinous litigation, leaving federally insured depository institutions at significant risk in their price-setting policies for banking deposit services authorized by the National Bank Act and other federal law	4
2. The decision below is in direct contravention of federal policy established by Congress in the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St Germain Depository Institutions Act of 1982, and to regulations of the Office of the Comptroller of the Currency which clearly preempt state action to the contrary	7
Conclusion	9

TABLE OF AUTHORITIES

Cases

Page

Franklin National Bank v. New York, 347 U.S. 373 (1954) 6, 7

Statutes and Regulations

12 U.S.C. § 24 ..... 3, 6

12 U.S.C. § 3501 7

12 C.F.R. § 7.8000 ..... 2, 3, 9

12 C.F.R. § 217.7 (*repealed* 1980) 7

Calif. Civil Code § 1670.5 ..... 2, 7

48 Fed. Reg. 38455 (1983) 7, 8

48 Fed. Reg. 54319 (1983) 8

49 Fed. Reg. 28237 (1984) 8

Public Laws

Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 7

The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 7

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BRIEF OF THE CALIFORNIA BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF APPEAL

INTEREST OF THE CALIFORNIA BANKERS ASSOCIATION

The California Bankers Association is the statewide trade association for the commercial banking industry in the State of California. Its membership consists of nearly all of the 450-plus commercial banks in the State of California, including 164 banks chartered by the United States.

This action involves reversal by the California Supreme Court of a judgment of dismissal in favor of a commercial bank chartered by the United States and with principal offices in the State of California. The complaint complained of a returned item service charge against a checking account customer of appellant when the customer wrote a check without depositing sufficient funds in his account, and sought review by the state courts of the amount of this charge. *Amicus,* as a trade association whose members offer deposit accounts to the general public, and whose

nationally-chartered members are subject to the authority and regulations of the Comptroller of the Currency, is directly affected by the decision below to the extent that such decision provides authority for the review and modification, in state court proceedings under California Civil Code § 1670.5, of the price terms on which its members may offer deposit accounts to the general public.

Amicus is also concerned about the potential for conflict between the obligations of its members under the Comptroller's regulations and examination procedures, especially 12 C.F.R. § 7.8000 (1985), and such court-ordered repricing of bank services.

Counsel for both appellant and appellee have expressly consented to the filing of this brief under Rule 36.1. The original letter of consent from each counsel is filed herewith.

SUMMARY OF THE ARGUMENT

If a returned check charge may be so reviewed and modified, then *any* deposit account fee or service charge set by a national (or federally insured state-chartered) bank may be subject to similar state restriction, notwithstanding that such fees are set in the open marketplace in a non-anticompetitive manner. The several fees which are applicable to a deposit account make up the "price" for that account in their totality, not in their separate amounts, and attacks on each separate piece of that totality will lead to multitudinous lawsuits and could lead to widely divergent holdings as to what is a "reasonable" price. In addition, this could result in a less than "reasonable" price being "approved" by state courts when all such cases are combined. The decision below would apparently place federally insured depository institutions, including national banks, partially in the position of a public utility, with their prices limited to "cost" plus a "reasonable" profit (without definition) while not assuring them of an overall "reasonable" rate of return as guaranteed to public utilities.

Commercial bank pricing structures are designed to recover costs of services, show a profit return, encourage some forms of business and discourage others, each bank deciding for itself the

relative importance of these factors for each of its charges. Absent anticompetitive behavior, these are decisions properly left to a free and independent management, not to the state courts. The power to price one's services is fundamental to business and necessarily incident to the powers national banks are given by the National Bank Act to engage in the "business of banking" and to "receive deposits." 12 U.S.C. 24 (Seventh).

Congress itself, and through Congress its federal regulatory creation the Depository Institutions Deregulation Committee, recognized that the Congressionally-mandated phasing out of interest rate restrictions on deposit accounts for all federally insured depository institutions necessarily meant a restructuring of pricing mechanisms in an open market place as well. This intended result—to ensure the safety and soundness of such federally insured institutions by allowing free market conditions to halt the outflow of deposit funds into other, nontraditional forms and entities—may not be invalidated by state court action.

Finally, regulations of the Office of the Comptroller of the Currency (found at 12 C.F.R. 7.8000) and examination practices thereunder are in conflict with the decision below.

For these reasons, we contend that the case at bar presents important questions of Federal law which have not been, but should be, settled by this Court.

ARGUMENT

The Supreme Court of the State of California, in reversing the judgment of dismissal in favor of appellant by the trial court, in effect ruled that the fees and service charges set by a nationally-chartered commercial bank in a competitive marketplace and after full disclosure to the customers of the bank are subject to judicial review by the state courts of California and to being set aside if those state courts find them to be unreasonable (Decision; *see* Appendix A to Appellant's Jurisdictional Statement at 11a-

13a).[1] *Amicus* California Bankers Association respectfully submits that this was error, and that a review by this court is necessary at this time in order to prevent a multitude of lawsuits throughout the nation challenging the several fees and service charges of national banks and other federally insured depository institutions on the same theory, leading either to extraordinary litigation costs incurred by such institutions in defending such attacks or to the inability of such institutions to respond appropriately to market conditions through their individual pricing policies due to a very reasonable fear of such litigation and its *ex post facto* effect.

1. The decision below will result in multitudinous litigation, leaving federally insured depository institutions at significant risk in their price-setting policies for banking deposit services authorized by the National Bank Act and other federal law

Although the decision below does not specifically address any commercial bank fee or charge other than appellant's returned check ("NSF") charge, the rationale of the decision is equally applicable to any fee or service charge established for deposit services by a commercial bank. Deposit accounts frequently involve a number of differing charges, and are not solely priced on the basis of NSF charges. There may or may not be monthly service charges, charges for the provision of checks, for the number of items processed during a given time period (perhaps with a set number being authorized without charge), or for the number of teller-related transactions or automated teller machine transactions, or both, conducted during each time period. Some or all of these charges may be dependent upon whether a specified minimum balance was maintained in the deposit account, or whether the average balance for the time period was above or below a set figure.

In short, the total "price" established by a commercial bank for a simple checking deposit account is an amalgam of a number of

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[1] All references hereinafter to the decision below will cite the appropriate page or pages of Appendix A to Appellant's Jurisdictional Statement.

individual pricing decisions, each designed either (1) to provide the customer with greater flexibility by allowing him or her to find an account with those pricing features which most nearly result in the customer paying for those services he or she really desires, or (2) to encourage the customer into account behavior which is consistent with the legitimate business goals and objectives of the bank.

The decision below, unless reversed, undoubtedly will result in attacks on the pricing policies of commercial banks throughout the country, with widely divergent holdings as to what is a "reasonable" price for not only the same but also the totality of services that go into the overall cost of both checking and nonchecking deposit accounts. If allowed to stand, the decision below will authorize a state court review with respect to the "cost" to a bank to provide the service, the "basis and justification" for the price, and the "true value" of the service (Decision; *see* Appendix A, at 11a).

Such a review would substitute the judgment of the state courts for that of the national bank defendant, not only well after the fact but also well after a marketplace decision in a fully competitive market! Is the California Supreme Court saying, as it apparently is (Decision; *see* Appendix A, at 13a) that in an open marketplace a commercial bank is entitled for its services only to a definite (but as yet undefined) percentage which it may "justify" as profit over and above its (similarly undefined) "cost"? *Amicus* California Bankers Association is unaware of any law or ruling that places commercial (and in particular, national) banks in the position of public utilities (nor does *amicus* urge that position now) and yet, without some prior approval process for fees and charges and a guaranteed return comparable to that which exists for public utilities, such a theory as expounded by the California Supreme Court could destroy the national banking system. *Amicus* submits that as rapidly as one case is disposed of another will surface. If a $6.00 NSF fee is held to be reasonable and not unconscionable, then what about $6.50? $7.00? Or perhaps the next (or even contemporaneous) attack will be on the monthly service charge; or the minimum balance for no-charge checking; etc.

In addition, even after winning such a case a bank would not be safe from attack. It would have to engage in an ongoing, continual review of each and every one of its account fees and charges to make sure that each of them constantly remains "justifiable" with respect to bank "cost" as market conditions and bank operations change. If a $6.00 fee is "justifiable" today and a new procedure implemented by the bank increases its efficiency, would $6.00 still be justified? Arguably not, under the decision below. Or if $6.00 is held *not* "justifiable" but rather only $5.00, and a $1.00 per transaction refund over millions of transactions is ordered, is there to be any consideration for the millions of dollars of fee income foregone by not charging other services to the highest amount "justifiable" as the bank legitimately seeks to encourage some forms of business and discourage others? In other words, are these not decisions which are properly—both in the business sense and under the law—best left to the bank so long as no anticompetitive behavior is involved?

The National Bank Act provides that national banks are authorized to "receiv[e] deposits" and that they possess "all such incidental powers as shall be necessary to carry on the business of banking . . . " 12 U.S.C. 24 (Seventh). This Court, in *Franklin National Bank v. New York*, 347 U.S. 373 (1954), held that these provisions preempted a state law prohibiting the use of the words "saving" or "savings" in a national bank's advertisements, saying:

> We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business.

Id. at 377.

Certainly, even more fundamental than advertising among the "incidental powers . . . necessary to carry on the business of banking," including that of "receiving deposits," is the power to price that business so long as not anticompetitive or violative of some other federal provision. Therefore, even if the decision below could be sustained as to banks chartered by the State of Califor-

nia[2], it clearly is erroneous with respect to national banks. It is not necessary to pass on the wisdom of Section 1670.5 of the California Civil Code. As this Court stated in *Franklin, supra*:

> However wise or needful New York's policy, a matter as to which we express no judgment, it must give way to the contrary federal policy.

Id. at 379.

2. The decision below is in direct contravention of federal policy established by Congress in the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St Germain Depository Institutions Act of 1982, and to regulations of the Office of the Comptroller of the Currency which clearly preempt state action to the contrary

In response to the introduction in the late 1970's of money market mutual funds to the marketplace and the tremendous "disintermediation" (outflow of funds from traditional depository institutions to these mutual funds) which then took place because of the interest rate differentials which existed, Congress passed the Depository Institutions Deregulation and Monetary Control Act in 1980 (the "1980 Act"), Pub. L. 96-221, 94 Stat. 132. Under this Act, the interest rate limitations on regulated depository institutions established by Regulation Q of the Federal Reserve Board (12 C.F.R. 217.7) were repealed and a new Congressional creation, the Depository Institutions Deregulation Committee ("DIDC") was instructed by Congress to phase out rate restrictions and let such rates be set by the marketplace. (*See* 12 U.S.C. § 3501). It was full recognized that such a policy would mean a restructuring of pricing mechanisms as well[3], which was

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[2] The propriety of the decision below vis-a-vis state-chartered institutions is, in the opinion of *amicus* California Bankers Association, also subject to challenge, especially in light of the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St Germain Depository Institutions Act of 1982, at least insofar as those institutions are insured by the Federal Deposit Insurance Corporation.

[3] *See* Appellant's Jurisdictional Statement, pp. 19-21, and footnotes thereto.

subsequently also recognized by DIDC in its consideration of the speed with which the rate differential phase-out ordained by Congress should occur.[4] That pricing mechanism, as indicated *supra*, is comprised of a number of different fees, services and charges and, given the tremendous competition for deposits that exists today throughout the country, flexibility in pricing is essential in order to determine what mix of services and charges will best respond to consumer desires and thus attract deposits. Both Congress, in enacting the 1980 Act, and DIDC, in implementing the same for all federally insured depository insitutions in accordance with its provisions, recognized that market-set interest rates and market-set account fees were necessarily inextricably intertwined. Market-set pricing of the several deposit accounts of all federally insured depository intitutions was thus intended by Congress and DIDC in order to bring about a market-set interest rate structure and may not be invalidated, in whole or in part, by a state court. In this, the court below was in error.

Of particular note, national banks such as appellant are subject to regulation and examination by the Office of the Comptroller of the Currency ("OCC"), and that Office has issued an interpretive Final Rule (appearing at 12 C.F.R. 7.8000, and 48 Fed. Reg. 54319 (December 2, 1983), *amended* 49 Fed. Reg. 28237 (July 11, 1984)[5]) which should be controlling herein and which clearly preempts state laws which may "prohibit [a competitively based]

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[4] *See* Final Rule of the Depository Institutions Deregulation Committee, August 24, 1983, published in 48 Federal Register, at 38455, wherein, in the Supplementary Information set forth with such Final Rule DIDC states:

> Over 40 percent of the commenters [to the December, 1982 proposal to eliminate the remaining rate ceilings or accelerate the deregulation of time deposits] indicated support for some form of accelerated deregulation . . . [These] commenters indicated that deregulation of all accounts would allow depository institutions to price their deposits in a way that would attract funds in the maturity categories that best match the maturities of their loans and investments.

[5] *See* Appendix I to Appellant's Jurisdictional Statement, at pages 76a and 82a.

charge or limit or restrict the amount of that charge".[6] *Amicus* California Bankers Association is strongly concerned that, unless reversed, the decision below will bring into conflict the obligations of its national bank members to comply with the mandate of the OCC in Section 7.8000 that service charges should be high enough to discourage customers from frequently writing checks without sufficient balances with a state court-ordered reduction of NSF charges to a figure based on cost plus a "reasonable" profit. Such a conflict will place amicus' national bank members in an impossible situation.

CONCLUSION

For all of the reasons stated herein, the *amicus* California Bankers Association, on behalf of its member banks, respectfully urges this Court to grant immediate review in this matter.

Respectfull submitted,

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January 15, 1986

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[6] 12 C.F.R. 7.8000, subd. (c).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

BRIEF OF *AMICUS CURIAE* WELLS FARGO BANK, N.A. IN SUPPORT OF JURISDICTIONAL STATEMENT OF CROCKER NATIONAL BANK

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF *AMICUS CURIAE* 1

SUMMARY OF ARGUMENT 4

ARGUMENT 4

State Court Regulation of National Bank Service Charge Pricing Is Substantively and Institutionally Inconsistent With the Regulatory Scheme Established by the Federal Banking Laws 4

CONCLUSION 12

TABLE OF AUTHORITIES

Cases	Page
Cantor v. *Detroit Edison Co.*, 428 U.S. 579 (1976)	9
E.I. Du Pont De Nemours & Co. v. *F.T.C.*, 729 F.2d 128 (2d Cir. 1984)	8
F.C.C. v. *RCA Communications, Inc.*, 346 U.S. 86 (1953)	9
First National Bank of La Marque v. Smith, 610 F.2d 1258 (5th Cir. 1980)	6
Franklin National Bank v. *New York*, 347 U.S. 373 (1954)	4
In re Japanese Electronic Products Antitrust Litigation, 723 F.2d 238 (3d Cir. 1983), *cert. granted*, 105 S.Ct. 1863, 85 L.E.2d 157 (April 1, 1985)	8
Independent Bankers Ass'n of America v. *Heimann*, 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied*, 449 U.S. 823 (1980)	5, 6
Investment Co. Institute v. *Camp*, 401 U.S. 617 (1971)	6
Jacobs v. *Citibank, N.A.*, 61 N.Y.2d 869, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (1984)	12
McCulloch v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819)	4
Theatre Enterprises, Inc. v. *Paramount Film Distributing Corp.*, 346 U.S. 537 (1954)	8
United States v. *Grinnell Corp.*, 384 U.S. 563 (1966)	8

FEDERAL STATUTES AND REGULATIONS

12 U.S.C.	
21	5
93(a)	5
93(b)	5
161	5
164	5
221-530	5
481-86	5
1811-32	5
1818(b)	2, 5

FEDERAL STATUTES AND REGULATIONS

	Page
15 U.S.C.	
1	8
2	8
45	8
28 U.S.C.	
1257(2)	12
1257(3)	12
12 C.F.R.	
7.8000	2, 6, 7, 9
7.8000(a)	6
(7.8000(b)	2, 6
7.8000(b)(1)	6, 7
7.8000(b)(2)	6, 7, 9
7.8000(b)(3)	6, 7

PUBLIC LAWS

Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469	5
The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132	5

COURT RULES

United States Supreme Court Rule 36.1	1

OTHER AUTHORITIES

P. Areeda, *Antitrust Analysis* (3d ed. 1981)	8

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BRIEF OF *AMICUS CURIAE* WELLS FARGO BANK, N.A. IN SUPPORT OF JURISDICTIONAL STATEMENT OF CROCKER NATIONAL BANK

INTEREST OF *AMICUS CURIAE*[1] WELLS FARGO BANK, N.A.

Wells Fargo Bank, N.A. ("Wells Fargo") is a national bank. As such, it is subject to a variety of federal banking statutes and to the authority and regulations of the Comptroller of the Currency. Wells Fargo does business in the State of California and thus is also subject to the decision appealed herein by Crocker National Bank ("Crocker"). Wells Fargo has a direct and immediate interest in the instant appeal.

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[1] This brief is timely filed with the written consent of the parties as required by United States Supreme Court Rule 36.1. Such consent documents are being lodged concurrently herewith.

The decision below subjects Wells Fargo and all other national banks operating in California to state court review of the charges levied for deposit account services ("service charges"). Such review is inconsistent with the regulatory scheme established by the federal banking statutes and regulations promulgated by the Comptroller. Title 12 C.F.R. section 7.8000 (1984) requires that service charges be set by each national bank on a competitive basis, in accordance with sound banking judgment and in a manner designed to achieve the statutory goal of a safe and sound national banking system. *See* 12 U.S.C. § 1818(b). Section 7.8000(b) expressly contemplates that national banks will consider cost, profit margin, and deterrence of misuse by customers of banking services, as well as their own competitive positions and marketing strategies in pricing service charges. Ultimately, those charges—like all other facets of national bank operations—are subject to review and regulation by the Comptroller.

The decision below is really quite extraordinary. In the absence of any allegation of anticompetitive conduct, and in the face of a federal regulation that expressly avows reliance on market forces to set service charge prices in the national banking system, the California Supreme Court has imposed a new and inconsistent standard—rooted in state contract law concepts of "unconscionability"—that constrains national banks to price their services at cost plus reasonable profit (Crocker's App. A at 35a), and permits liability to be imposed by state courts even where the price charged is equal to or below the market price (App. A at 11a). The conflict between these two standards is clear and direct: the federal regulation contemplates that pricing will be determined by the market subject to the Comptroller's statutory review, while the decision below imposes *ad hoc* review by various state courts under a standard that would permit market prices to be held "unreasonable" even absent allegations of anticompetitive conduct.

Wells Fargo is currently involved in four class action lawsuits that are virtually identical to the instant case.[2] All of these cases are presently stayed pending the outcome of this appeal. The complaints in these cases seek declaratory and injunctive relief as well as damages for various overlapping periods between 1973 and 1985. Plaintiffs seek to recover as damages all charges for non-sufficient funds (hereinafter "NSF") checks collected by Wells Fargo during this period, to the extent such charges are found to be unreasonable or unconscionable under state law. The amount of money at stake for the national banks in California is staggering. The total for all NSF charges collected by Wells Fargo alone in the 1973-85 period is approximately $140 million.

Moreover, the principle announced below is not limited to NSF charges, but may be applied to the prices charged by national banks for virtually every service and product. In the business and consumer checking areas alone (excluding collection services), Wells Fargo's pricing structure currently includes over 65 separate charges. Hundreds of other charges apply in areas such as cash management, domestic and international exchange and letters of credit, funds transfers, securities services, and collections. In short, the decision of the California Supreme Court threatens to unleash a new wave of state court actions challenging virtually every aspect of national bank operations. It simply cannot be reconciled with a national banking system in which service charge pricing is intended by federal law to be governed by market forces and uniformly reviewed in a single federal venue.

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[2] These actions, all of which are now pending in the Superior Court of California for the City and County of San Francisco, are *Dorothy DeOliveira, etc., et al.* v. *Wells Fargo Bank, N.A., et al.* (No. 720-307); *Margaret Peterson, etc., et al.* v. *Wells Fargo Bank, N.A., et al.*, (No. 722-191); *Dee Filichia, etc., et al.* v. *Wells Fargo Bank, N.A., et al.*, (No. 820-481); and *Judy Baugh, etc., et al.* v. *Wells Fargo Bank, et al.*, (No. 820-483). All of these actions have been brought as class actions, and the *DeOliveira* case has already been certified as a class action.

SUMMARY OF ARGUMENT

Federal law charges the Comptroller of the Currency with responsibility for implementing the national banking laws. Pursuant to this mandate, the Comptroller regularly examines the pricing practices of each national bank to ensure that the "safety and soundness" of the system have not been compromised. The Comptroller has promulgated regulations setting forth guidelines to be utilized by national banks in pricing their deposit account service charges. The decision below permits state trial courts to review those charges under substantive standards that conflict with the federal standards. *Ad hoc* state court review of discrete charges levied by individual banks for particular services under a "reasonableness" standard is simply inconsistent with the federal regulatory scheme, which anticipates uniform review by the Comptroller of each national bank's integrated pricing structure and reliance on market forces to guide national banks in their service charge pricing decisions. The California Supreme Court failed to comprehend the actual and direct conflict with federal law occasioned by state court intervention in this area. Its preemption analysis is erroneous and must be reversed.

ARGUMENT

State Court Regulation of National Bank Service Charge Pricing Is Substantively And Institutionally Inconsistent With The Regulatory Scheme Established By The Federal Banking Laws.

Since *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819), it has been established that the federal government may charter national banks and that such banks may be immune from state laws. While the structure of the national banking system has undergone changes since 1819, the federal interest in that system has not. "The United States has set up a system of national banks as federal instrumentalities to perform various functions such as providing circulating medium and government credit, as well as financing commerce and acting as private depositories." *Franklin National Bank* v. *New York*, 347 U.S. 373, 375 (1954).

As a national bank, Wells Fargo is subject to the National Bank Act (12 U.S.C. § 21, *et seq.*), the Federal Reserve Act (12 U.S.C. §§ 221-530), and the Federal Deposit Insurance Corporation Act (12 U.S.C. §§ 1811-32), as well as two recent banking deregulation acts (The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132, and the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469). Although Crocker's Jurisdictional Statement discusses in detail the authority of the Comptroller to review and regulate national bank pricing practices pursuant to these laws, certain features of this system bear highlighting.

The Comptroller is obligated to determine whether a national bank is engaging in an "unsafe or unsound practice" and to issue cease and desist orders where such practices are found. 12 U.S.C. § 1818(b). This power is very broad:

> National banks are perhaps as meticulously regulated as any industry. Every aspect of their affairs is scrutinized to assure financial soundness and ethical practice. The Comptroller's statutory duties require the closest monitoring and continuous supervision of these institutions. Thus, the Comptroller's discretionary authority to define and eliminate "unsafe and unsound" conduct is to be liberally construed.

Independent Bankers' Ass'n of America v. *Heimann*, 613 F.2d 1164, 1168-69 (D.C. Cir. 1979) (footnote omitted), *cert. denied*, 449 U.S. 823 (1980). In addition, the Comptroller may institute civil proceedings for the forfeiture of all rights, privileges, and franchises of any national bank that violates various provisions of the National Bank Act. 12 U.S.C. § 93(a). The Comptroller may impose civil penalties upon any national bank (or officer, director, employee, or agent thereof) which (or who) violates such provisions or any *regulation* issued thereunder. 12 U.S.C. § 93(b). The Comptroller also enjoys the comprehensive visitorial powers necessary to enforce these and other banking laws. 12 U.S.C. §§ 161, 164, 481-86.

Pursuant to this statutory mandate, the Comptroller has promulgated 12 C.F.R. § 7.8000,[3] which sets forth explicit guidelines for the pricing of deposit account service charges by national banks.[4] Section 7.8000(a) expressly requires that service charges be priced by each bank on a competitive basis. Section 7.8000(b) requires

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[3] 12 C.F.R. section 7.8000 provides as follows:

Charges by national banks.

(a) All charges to customers should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding or discussion with other banks or their officers.

(b) Establishment of deposit account service charges, and the amounts thereof, is a business decision to be made by each bank according to sound banking judgment and federal standards of safety and soundness. In establishing deposit account service charges, the bank may consider, but is not limited to considering:

(1) Costs incurred by the bank, plus a profit margin, in providing the service;

(2) The deterrence of misuse by customers of banking services;

(3) The enhancement of the competitive position of the bank in accord with the bank's marketing strategy;

(4) Maintenance of the safety and soundness of the institution.

(c) A national bank may establish any deposit account service charge pursuant to paragraphs (a) and (b) of this section notwithstanding any state laws which prohibit the charge assessed or limit or restrict the amount of the charge. Such state laws are preempted by the comprehensive federal statutory scheme governing the deposit-taking function of national banks.

[4] There is no question that the Comptroller has the authority to issue rules "defining and explicating the practices which in his discretion he finds threatening to a stable and effective national bank system." *Independent Banker's Ass'n of America* v. *Heimann*, 613 F.2d 1164, 1169 (D.C. Cir. 1979) (footnote omitted), *cert. denied*, 449 U.S. 823 (1980). Although the *Heimann* case involved a formal regulation promulgated after notice and comment and section 7.8000 is technically an interpretive regulation, the Comptroller's broad authority to define and explicate unsafe and unsound banking practices extends beyond formal notice and comment regulation. *See, e.g., First National Bank of La Marque* v. *Smith*, 610 F.2d 1258, 1263-65 & n.9 (5th Cir. 1980) (upheld informal "letter directives" stating Comptroller's opinion re unsafe and unsound practices and Comptroller's intention to act on such opinion). Moreover, this Court has stated that "great weight" should be given to the "deliberative conclusions" of the Comptroller as to the meaning of the banking laws. *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 626-27 (1971).

that pricing decisions be made "according to sound banking judgment and federal standards of safety and soundness." Those standards include consideration of such factors as costs, profit margin, and the deterrence of misuse by customers of banking services. 12 C.F.R. § 7.8000(b)(1) & (2). In addition, the Comptroller has recognized and endorsed the importance of considering competitive position and marketing strategy in pricing deposit account service charges. 12 C.F.R. § 7.8000(b)(3).

The program of price regulation imposed by the California Supreme Court is in direct conflict with the federal scheme.[5] Under the court's decision, national banks are permitted only to charge fees "sufficient to recover the cost of the services and a reasonable profit." (App. A at 35a). In assessing the reasonableness of the fee, courts should "consider not only the market price, but also the cost of the goods or services to the seller, the inconvenience imposed on the seller, and the true value of the produce (sic) or service," as well as "the 'procedural aspects' of unconscionability," such as "the absence of meaningful choice, the lack of sophistication of the buyer, and the presence of deceptive practices by the seller." (App. A at 11a-12a) (citations omitted). The court expressly found that a price equal to the market price can be held unconscionable, as, for example, where it is set by an oligopoly. (*Id.*). Thus, under the court's decision, prices set in response to market conditions may be declared unreasonable and hence unlawful, even though they are not the result of anticompetitive conduct.

This holding cannot be squared either with the standards set forth in section 7.8000 or with federal antitrust jurisprudence. Oligopoly, without proof of conspiracy, is

[5] Preemption may also be established in this case by Congress's intent to occupy the relevant field. In this connection, it should be noted that the court below failed to focus its preemption analysis on the relevant "field." That field is service charge price regulation, not "the field of regulation of contracts between national banks and their depositors" (App. A at 26a) or "any banking matter related to deposits." (App. A at 28a).

not unlawful under section 1 of the Sherman Act (15 U.S.C. § 1). *Theatre Enterprises, Inc.* v. *Paramount Film Distributing Corp.*, 346 U.S. 537, 540-41 (1954). Similarly, oligopoly or "shared monopoly" has never been held to violate section 2 of the Sherman Act (15 U.S.C. § 2) without proof of a conspiracy to monopolize. P. Areeda, *Antitrust Analysis* § 267 at 289 (3d ed. 1981); *see In re Japanese Electronic Products Antitrust Litigation*, 723 F.2d 238, 316 (3d Cir. 1983) (summary judgment affirmed as to certain defendants for failure to prove conspiracy to acquire shared monopoly power), *cert. granted*, 105 S. Ct. 1863, 85 L.E.2d 157 (April 1, 1985); *cf. United States* v. *Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (offense under § 2 requires proof of the willful acquisition or maintenance of monopoly power as distinguished from growth due to superior product, business acumen, or historic accident). Creative attempts to attack oligopolistic behavior under section 5 of the Federal Trade Commission Act (15 U.S.C. § 45) have also been rejected. *E. I. Dupont De Nemours & Co.* v. *F.T.C.*, 729 F.2d 128, 137-140 (2d Cir. 1984). While the court's discussion of unconscionability law raises numerous questions about which factors may be considered in determining "reasonableness,"[6] the thrust of the decision is unmistakable: state courts are to judge national bank service charges on the basis of a "fairness" standard that may or may not produce pricing consistent with market conditions.

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[6] Among the considerations mentioned by the court are the following: "the commercial setting, purpose, and effect" of the charge (App. A at 10a); "the basis and justification for the price" (App. A at 11a); "the market price" (*Id.*); "the cost of the goods and services to the seller" (*Id.*); "the inconvenience imposed on the seller" (*Id.*); "the true value" of the product or service (*Id.*); "the absence of meaningful choice" (*Id.*); "the lack of sophistication of the buyer" (App. A at 12a); and "the presence of deceptive practices by the seller" (*Id.*). The presence of so many substantive standards, which in themselves conflict with the court's central test of cost plus a reasonable profit, injects tremendous uncertainty into bank pricing decisions and bank management generally. Such uncertainty in itself frustrates the purposes of the national banking laws; few matters could be more threatening to the safety and soundness of the national banking system than uncertainty of the magnitude now faced by national banks operating in California.

The "reasonable profit" standard—typically used in public utility ratemaking—cannot appropriately be applied to regulate service charge pricing in the national banking system. Public utilities are considered natural monopolies whose services can be efficiently allocated only by setting prices equal to actual cost plus a reasonable rate of return on investment. *See generally, Cantor* v. *Detroit Edison Co.*, 428 U.S. 579, 595-96 (1976); *F.C.C.* v. *RCA Communications, Inc.*, 346 U.S. 86, 92 (1953). No similar contention has been made—or can be made—regarding the banking industry. Indeed, plaintiffs have not even alleged anticompetitive conduct. The decision below, if permitted to stand, would prevent national banks from pricing their services at the market rate if a state trial court finds, for example, that the rate does not reflect the "true value" of the service.[7] (App. A at 11a). This standard simply cannot be made to fit within a program of federal regulation that relies upon market conditions to shape pricing decisions and assure the safety and soundness of the system.

As the court below acknowledged, the two recent banking deregulation acts evidence Congress's intention to end the subsidy of depositor services that had resulted from federal limits on the interest that could be paid to depositors, and to enable banks to charge fees sufficient to recover the cost of those services. (App. A at 35a). Congress plainly contemplated that such deregulation would lead to increased competition in the pricing of national bank services (*see* citations in Crocker's Jurisdictional Statement at 19-20), and section 7.8000 reflects this intended reliance on market forces, subject to the Comptroller's supervisory authority. Although the court below dismissed actual conflict between the federal regulation and its "reasonableness" standard as "a remote and unlikely possibility" (App. A at 34a), such conflict is inherent. National banks can price like competitors responding to market conditions or they can price like

[7] In addition, the decision may directly impair the safety and soundness of a national bank by removing a needed deterrent to NSF check writing. 12 C.F.R. § 7.8000(b)(2).

regulated utilities; they cannot do both. The court's argument that the dual system of bank regulation would be destroyed by a finding of preemption based on the possible interpretations of federal law by bank directors (*id.*) is misplaced; the "reasonableness" standard promulgated below substitutes regulation for competition as the price-setting mechanism and permits liability to be imposed for pricing that responds to market conditions, thereby raising an actual conflict with the standards set forth in the Comptroller's regulation.

Beyond this conflict in substantive standards, implementation of those standards by common law courts would frustrate the purposes and efficacy of federal regulation. Unlike administrative ratemaking, which is undertaken pursuant to procedures that assure uniformity in the review and establishment of rates and the recapture of all utility costs, piecemeal review by various state courts will inevitably result in disparate rulings on various challenged prices, making it impossible for national banks to develop an integrated pricing strategy that assures their sound and efficient operation. Thus, Wells Fargo may find that it has failed to recover all of its costs when different triers of fact, considering challenges to particular service charges, allocate costs differently in applying the "reasonableness" standard to the challenged prices.[8] The problem is compounded for Wells Fargo, which operates in forty-four California counties, and will face a different trier of fact in each county where it is sued. Moreover, national banks may now find that many of their costs are unrecoverable because of the practical difficulties in accounting for them, given that detailed historical cost data has not heretofore been required.

The decision below also threatens to impair the market's efficient operation, since different banks will be

[8] This very problem is posed in *Filichia, etc., et al.* v. *Wells Fargo Bank, N.A., et al.*, where plaintiffs are challenging the bank's "deposited item returned charge," which is imposed on the account of a payee who deposits someone else's NSF check. The cost items relating to this charge may partially overlap those relating to NSF charges, especially when both drawer and drawee are customers of the same bank.

subject to review of their charges by different triers of fact, and thus will be made to operate under different pricing standards. At best, state courts will validate as "reasonable" prices that have been established in response to market conditions; more likely, the result will be a patchwork of pricing decisions reflecting the views of particular triers of fact as to what constitutes "fairness" in this consumer setting. Undoubtedly, some banks will be enjoined from charging competitive prices. This lack of uniformity contrasts starkly with the federal scheme, where national bank examination and review is carried out by a single agency—the Office of the Comptroller of the Currency.[9]

The scheme established below also conflicts with past federal regulation because it operates retrospectively. As noted below, Wells Fargo is now facing challenges to all of the NSF charges it has collected since 1973, totalling approximately $140 million. To require Wells Fargo to disgorge those sums would upset years of federal regulation involving regular examination by federal officials as well as consultation regarding and approval of pricing. The impact of retroactivity on the safety and soundness of national banks is especially severe because the banks cannot now recover those charges in other ways. Wells Fargo no doubt would have adopted very different marketing strategies had it known that it could be subjected to the law made below. Even beyond the retroactivity problems caused by the cases now pending, price regulation by common law courts would, by its very nature, impose delays that frustrate business planning and are inconsistent with the purposes of federal banking law, which requires certainty in order to assure safety and soundness.

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[9] The uniformity problem is compounded by the fact that there is no uniform industry-wide system of accounting to show each bank's cost of processing NSF checks. This does not pose a problem for the federal regulator. The Comptroller uses expert bank examiners who conduct regular, detailed examinations of all national bank operations. It does pose problems for state trial courts, each of which would be required to assess the costs of individual banks.

In sum, the *ad hoc* price evaluation scheme established by the decision below is inconsistent, both substantively and institutionally, with the type of regulation established by the federal banking statutes and the regulations, policies and practices of the Comptroller. Congress has sought to achieve a safe and sound national banking system by deregulating interest rates and promoting competition among national banks in the pricing of their services and products. The highest court of the State of New York has already held that federal law preempts state law challenges to the pricing of national bank service charges. *Jacobs* v. *Citibank, N.A.*, 61 N.Y.2d 689, 462 N.E.2d 1182, 474 N.Y.S.2d 464 (1984). The holding of the court below simply cannot be reconciled with federal regulation in this area.

CONCLUSION

For the foregoing reasons, Wells Fargo respectfully submits that the decision below is contrary to federal law and is appealable under 28 U.S.C. section 1257(2), or, in the alternative, presents federal questions so substantial as to merit this Court's review by writ of certiorari under 28 U.S.C. section 1257(3). The decision of the California Supreme Court should be reversed.

RESPECTFULLY SUBMITTED,

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In the Supreme Court

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United States

OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

BRIEF OF BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, *AMICUS CURIAE*, IN SUPPORT OF THE JURISDICTIONAL STATEMENT OF CROCKER NATIONAL BANK

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TABLE OF CONTENTS

	Page
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	3
The California Supreme Court decision fundamentally threatens the safety and soundness of national banks doing business in the State of California, in that it provides for judges or juries to set prices for bank services retroactively, on an *ad hoc* basis, and subverts federal preemption	3
CONCLUSION	6

TABLE OF AUTHORITIES

Cases

Cantor v. Detroit Edison Co., 428 U.S. 579, 595-96 (1976) 5

Fidelity Federal Savings & Loan Ass'n v. De La Cuesta, 458 U.S. 141 (1982) 5

Franklin National Bank v. New York, 347 U.S. 373 (1954) 5

Jacobs v. Citibank, N.A., 61 N.Y. 2d 689, 462 N.E. 2d 1182, 1183, 474 N.Y.S. 2d 464 (Ct. App. 1984) 5

Federal Statutes

Federal Reserve Act (12 U.S.C. § 221-530) 1

Federal Deposit Insurance Corporation Act (12 U.S.C. § 1811-32) 1

National Bank Act (12 U.S.C. § 21 et seq.) 1

Public Laws

Garn-St Germain Depository Institutions Act of 1982, Pub.L. 97-320, 96 Stat. 1469 2

The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub.L. 96-221, 94 Stat. 132 1

California State Statutes

California Civil Code § 1670.5 3

California Financial Code § 865.4 2

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This brief is filed under Rule 36.1 of the Rules of this Court with the consent of all the parties.

INTEREST OF AMICUS CURIAE

Bank of America National Trust and Savings Association is a national trust and savings association created under the laws of United States of America, with its principal place of business in San Francisco, California. Bank of America is subject to the provisions of the National Bank Act (12 U.S.C. § 21 *et seq.*), the Federal Reserve Act (12 U.S.C. § 221-530), the Federal Deposit Insurance Corporation Act (12 U.S.C. § 1811-32) and the two recent banking deregulation acts, the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub.L. 96-221,

94 Stat. 132, and the Garn-St Germain Depository Institutions Act of 1982, Pub.L. 97-320, 96 Stat. 1469. Further, Bank of America is subject to the powers and regulations of the Comptroller of the Currency regarding deposit accounts. Bank of America offers deposit accounts to the general public.

For over fifty years, Bank of America's deposit account customers have contracted with the Bank to pay and have paid a service charge for handling checks presented to the Bank for payment against an account which has insufficient funds ("NSF" charges). The Bank's service charge has run from $.50 per item in the 1930's to the current $10.00 charge. The amount of the service charge is disclosed in writing to the customer when a checking account is opened and whenever the amount of the charge changes. California Financial Code § 865.4 (1977). *See* JS at 5.

Six lawsuits covering NSF charges are pending currently against Bank of America in the Superior Court of California for the City and County of San Francisco. They consist of one certified statewide class action, two abated and uncertified statewide class actions, two other stayed uncertified statewide class actions, and a recently filed sixth uncertified statewide class action. All of these overlapping cases, and numerous similar suits against many other California banks, await the outcome of the Crocker National Bank appeal. Each of these suits claims the Bank of America's price is excessive or unconscionable. Each seeks enormous damages in the nature of a refund of most of the service charge paid by the Bank's customers as far back as any statute of limitation will permit, declaratory relief compelling a reduced price in the future and punitive damages.

SUMMARY OF ARGUMENT

The California Supreme Court decision fundamentally threatens the safety and soundness of national banks doing business in the State of California, in that it provides for judges or juries to set prices for bank services retroactively, on an *ad hoc* basis, thereby subverting federal preemption.

ARGUMENT

The California Supreme Court decision amounts to judicial legislation establishing a judge or jury as the retroactive price setter for bank service charges. Under this decision national banks would face review by a judge or jury of the price of their NSF charges, and perhaps other service charges as well, long after the services have been performed and the charges have been paid by the customer.

That retroactive review would be permitted under the simple rubric that a bank's service charge may be "unconscionable" under § 1670.5 of the California Civil Code.[1] While the California Supreme Court suggests various factors to be considered in this review, such as, the "costs" to the bank to provide the service, "the basis and justification for the price," and the "true value" of the service (App. A. at 11a; JS at 6), the court's scheme would simply permit a judge or jury to decide that in its opinion any service charge was too high. This could happen notwithstanding the acceptability of the price by the Comptroller in his examination with respect to the safely and soundness of a bank's operation and compliance with applicable law.

Title 12 C.F.R. § 7.8000 (1984) requires that national bank service charges be set on a competitive basis, in accordance with sound business judgment and in a manner designed to achieve the statutory goal of a safe and sound national banking system. *See*, 12 U.S.C. § 1818(b). The National Bank Act confers compre-

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[1] California Civil Code § 1670.5 (1979) reads:

"(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination."

hensive review and enforcement powers on the Comptroller of the Currency to assure the safety and soundness of the national banking system. *See*, citations generally set forth in Crocker National Bank's jurisdictional statement, page 14. In rejecting Crocker's preemption argument, the California Supreme Court rejects the federal regulatory scheme set forth in the National Banking Act and the powers of the Comptroller to regulate the safety and soundness of national banks.

The court's decision does not require adherence to the guidelines issued by the Comptroller of the Currency for pricing deposit account service charges. Those guidelines include, among others, consideration of deterrence of misuse by customers of a banking service, enhancement of a bank's competitive position, and maintenance of its safety and soundness. 12 C.F.R. § 7.8000(b). The court's olive branch footnote 42 (App. 34a-35a), which tries to remove any actual conflict between state and federal law by allowing a court to use the same factors set forth in the Comptroller's regulation in deciding whether a fee is unreasonable or unconscionable, skirts the real issue behind preemption. The Comptroller through examination is to determine the safety and soundness of national banks. The Comptroller has the duty and expertise to regulate uniformly and consistent with national policy. A judge or jury has no such experience or responsibility and can hardly be expected to acquire such during the course of a trial.

The depth of the conflict between this judicially created rate setting procedure and the national system of banking regulation is fully highlighted by the court allowing for the invalidation of a price which is equal to or less than the prevailing market price (JS at 6). Although the court admits that it is unlikely a court would find a price set by a freely competitive market to be unconscionable, that is not precluded by the factors suggested for reviewing price. Also the court decides that a price set in an oligopoly setting should not be immune from scrutiny, App. A. at 11(a), notwithstanding the lack of any pleading by plaintiff of a conspiracy to set price or monopolize (JS at 6-7). This flies squarely against the Comptroller's ruling here that national bank

service charges be set on a competitive basis. Title 12 C.F.R. § 7.8000.

Even were the court decision limited to prospective price setting, it would still conflict with national policy regarding the pricing of banks' services (JS at 17-22). The decision of the court leaves the price setting to a judge or jury, and not a legislatively created body, such as a public utility commission or in this matter, the Comptroller of the Currency.

A judge or jury has no substantive rules or experience for setting price, whether the Comptroller is charged with the responsibility and obligation of overseeing banks, in a manner that requires uniform application to the entities it governs. *See, e.g.* pertinent statutes, regulatory obligations, interpretive rulings and the Comptroller's *Handbook for National Bank Examiners* set forth in JS Appendix.

The Comptroller must not consider prices in a vacuum but in accordance with sound business judgment and in a manner designed to achieve the statutory goal of a safe and sound national banking system. 12 U.S.C. § 1818(b). Similarly, a public utility commission charged with regulating the prices of utilities is also charged with granting a rate of return it determines to be reasonable to support the utility's existence, level of public service and adequate ability to raise capital. *See generally, Cantor v. Detroit Edison Co.*, 428 U.S. 579, 595-96 (1976). The Comptroller of the Currency has spoken uniformly to national banks on the manner in which they should set price to effectuate their safety and soundness. Title 12 C.F.R. § 7.8000 (1984). A state regulatory scheme as this one created by the California Supreme Court simply dissolves all certainty and threatens our system of national banks. In our governmental structure, rate making is properly left to a legislative body or a legislatively created agency designed to oversee the complex process. *See, e.g. Jacobs v. Citibank N.A.*, 61 N.Y. 2d 689, 462 N.E. 2d 1182, 1183, 474 N.Y.S. 2d 464 (Ct. App. 1984); *Cf. Franklin National Bank v. New York*, 347 U.S. 373 (1954); *Fidelity Federal Savings & Loan Ass'n. v. De La Cuesta*, 458 U.S. 141 (1982).

National banks now face federally mandated deregulation of interest rate ceilings, and find themselves in competition for deposits not only with other banks but with brokerage houses (Merrill Lynch) and department stores (Sears Roebuck & Co.). *See*, Reply Brief of Amicus Curiae Comptroller of the Currency with respect to the Comptroller's interpretive ruling (JS App. 104a-118a). National banks must be free to set their prices on a competitive basis in the market place, consistent with sound business judgment and without the interference of *ad hoc* judge or jury retroactive price setting decisions. Their safety and soundness are threatened by the state price setting scheme established here which is contrary to national policy.

CONCLUSION

For the reasons stated, this court should exercise its plenary jurisdiction to review and reverse the judgment of the California Supreme Court.

Respectfully submitted,

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